**From:** Tax Strategy, Treasury
**To:** Office of the Minister of Finance
**Cc:**
**Subject:** Treatment of NZ Super in tax change scenarios
**Message Flag:** 11.0
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[SEEMAIL]

Hi

As discussed on Wednesday, we have realised we were not calculating the impact from tax changes to NZ Super correctly for earlier tax change scenarios. However because of the interaction between the level of net NZ Super payments and capital contributions to the super fund, the net fiscal cost does not change materially.

Consistent with our previous note on the 15th of November, the gross revenue cost is partially offset by reductions in benefit appropriations (tax reductions do not flow through to beneficiaries so tax reductions on benefit payments reduce gross costs to the crown).

The treatment for super annuitants is different. Where taxes are changed on 1 April, the new rate of net NZ Super for the following year is calculated in the following order: (1) the new tax schedule is applied to the prior year's Gross NZ super to give a new rate of net NZ Super (this is the direct impact of the tax reduction); (2) the CPI adjustment is then applied to this new rate net NZ Super; (3) the CPI adjusted net NZ Super is increased again if it is below the 65% floor of the net average wage, where the latter is calculated under the new tax schedule. Previously we had missed out step one and taken the rate of net NZ Super from the prior year and applied (2) and (3).

This means there is unlikely to be a reduction in gross NZ super appropriations in the first year of any tax reduction. For the two scenarios we gave you on Friday the 23rd there will eventually be a reduction in gross super in future years as the difference between gross and net NZ super is reduced because of the lower tax rates. This means the costs we provided you on Friday 23rd of Nov which showed a reduction in gross NZ super appropriations were not correct; there should be instead an increase in gross NZ Super appropriations. A revised breakdown of the costs for the two scenarios is attached.

Offsetting this increase to NZ super appropriations is a reduction in the level of contributions to the NZ super fund. This occurs because changes to the tax rates require recalculation of contributions to the super fund. This actually calculates the sum of both the annual capital contributions plus net NZ Super. It is this combined cost that is smoothed over the 40 years, so a large increase in Net NZ Super in the first year from the tax change results in a reduction to capital contributions in that year. This decrease in capital contributions is a short term thing as under both scenarios contributions start increasing again in 4-5 years.

It is this reduction in capital contributions that means the net fiscal cost for the scenarios we gave you on the 23rd do not turn out to be all that different to the revised cost.

One other quirk is that the combined capital contribution plus net NZ Super cost is calculated for the government fiscal year.  This means if a tax reduction were to take affect from 1 April, while only 1/4 of the cost of increased Net NZ super would fall within this year the new smoothed combination of capital contributions and net NZ super applies for a full year.  This means there is  likely to be an increase in net super contributions in the year the tax reduction applies.

What this means for the two scenarios we gave you on the 23rd is that that the cost before tax clawback (increases in other taxes), fund contributions and finance cost increases by $570m for scenario 1 and $270m for scenario 2.  As noted above, offsetting changes to fund contributions mean the net fiscal cost is much the same as before (only $30m difference).

Happy to provide any further clarification.

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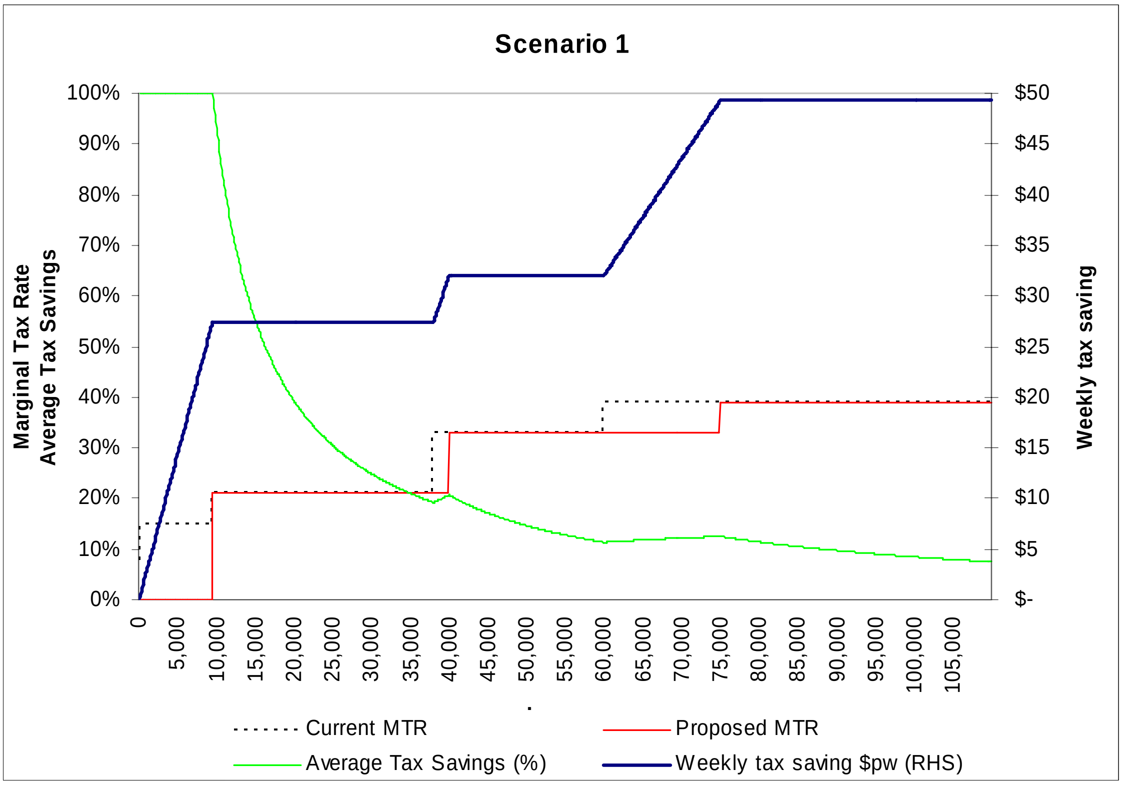
Tax Strategy | The Treasury

### Scenario 1

| Threshold[1] | Rate |
|---|---|
| 0k | 0% |
| 9.5k | 21% |
| 40k | 33% |
| 75k | 39% |

1. LIR removed

| Fiscal Cost ($ million) | 2009/10 | Revised |
|---|---|---|
| Gross Cost | 4867 | 4708 |
| NZS Impact | -552 | 175 |
| Benefit appropriations | -526 | -526 |
| *Disposable income* | *3789* | 4358 |
| | | |
| Extra tax revenue | -947 | -1089 |
| NZS Fund Contributions | 129 | -270 |
| Investment Income | 178 | 180 |
| **Net Fiscal Cost** | **3149** | **3179** |



## Scenario 2

| Threshold[1] | Rate |
|---|---|
| 0k | 10% |
| 18k | 21% |
| 40k | 33% |
| 75k | 39% |

1. LIR removed

| Fiscal Cost ($ million) | 2009/10 | Revised |
|---|---|---|
| Gross Cost | 4273 | 4222 |
| NZS Impact | -288 | 31 |
| Benefit appropriations | -299 | -299 |
| *Disposable income* | *3686* | 3954 |
| | | |
| Extra tax revenue | -922 | -989 |
| NZS Fund Contributions | 129 | -40 |
| Investment Income | 174 | 176 |
| **Net Fiscal Cost** | **3067** | **3101** |