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## The Tax Working Party

[By email]

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## Tax aspects of Workplace Savings

### Introducing ASFONZ

ASFONZ is a national, not-for-profit, apolitical membership organisation that represents the interests of employers who offer workplace superannuation, their trustees & members, as well as superannuation industry service providers and professional advisers.

Our membership embraces all types of workplace superannuation schemes (KiwiSaver, public & corporate, union-sponsored & industry-based), as well as employers and service providers to the workplace superannuation industry. Current membership comprises around 100 major workplace superannuation schemes & KiwiSaver schemes, and around 50 organisations representing the various product and service providers for workplace superannuation.

The **mission** of ASFONZ is to be the Voice of Workplace Savings, advancing the sustainable, effective, and efficient delivery of workplace savings outcomes for all involved.

ASFONZ seeks to achieve that mission through:

- Promoting ASFONZ as the "Voice of Workplace Savings"
- Working with the Government to develop policies that achieve improved workplace savings and KiwiSaver outcomes.
- Identifying and promoting initiatives and reforms that will provide efficiencies and enhancements to minimise the extent to which regulatory factors impede delivery of effective and efficient workplace savings outcomes, and those that will encourage sustainable participation in workplace savings.

- Supporting employers, trustees and providers in their delivery of optimal workplace savings outcomes
- Improving public confidence in workplace savings by consistently reinforcing integrity, accountability, and professionalism within the workplace savings industry
- Serving ASFONZ members, and its supporters, by providing a range of services to meet their needs and deliver value for their participation.

### **Purpose of submission**

There are a number of features of the current tax system that impact on the nature and adequacy of the savings that New Zealanders have for retirement. As the voice of workplace savings, ASFONZ wishes to ensure that these matters are considered by the Tax Working Party, or at least form a part of the public debate generated as a consequence of the Working Party.

We understand that the Tax Working Party's (TWP) brief is very broad and, as a consequence, there is limited time available for considering specific issues. However, ASFONZ considers retirement savings, and our nation's ability to maintain an adequate level of income and standard of living in retirement, to be significant issues for the current Government and Governments of the future.

In light of the importance of the retirement income issues, we have focussed our submission on:

- Accumulation of retirement savings, particularly workplace superannuation and KiwiSaver
- Options for post-retirement, including availability of annuity products
- Impact of the tax system on these issues

### **The role of workplace savings**

Retirement savings in New Zealand is at a critical juncture. We currently have both the need and the opportunity to look at New Zealand's approach to taxation as it impacts long term savings. ASFONZ believes that workplace savings will play a critical roll in the accumulation of retirement savings for New Zealanders and, given adequate support and an encouraging tax regime, that it could relieve some of the burden of funding superannuation in the future.

We believe that there is a need for Government to do more to ensure retirement savings of New Zealanders is sufficient both as to quantum and quality.

KiwiSaver has provided a starting point for increasing participation in workplace savings. This combines with other work being done in the investment and retirement savings space, including the introduction of the PIE tax regime to reduce distortions that made collective investment relatively unattractive, the regulatory work being done with MED with the Regulation of Financial Product Providers (RFPP) and the work of the Retirement Commissioner, for example.

While these are all contributing meaningfully to the savings environment, tax neutrality and greater regulation does little to generate the momentum needed to change savers' behaviour. Gaining that momentum is necessary, whether the desired change in state is from consumption to saving, from housing assets to financial assets, or any other shift that is considered necessary to enhance New Zealand's future economic well-being.

In particular, we consider the contrast to Australia to be sobering. While this might be subject to some debate, it appears that we are behind Australia, and losing ground, in our level of earnings, savings (and hence investment), standards of living and projected retirement incomes. These trends seem unlikely to reverse without some changes to policies, including tax.

There are many forms that such intervention could take and we are conscious of the need to maintain fiscal neutrality. For this reason we do not advocate any particular solution, but wish to encourage and promote open debate on these issues in an effort to reach a solution that is viable for the long term benefit of New Zealand and New Zealanders.

### **Issues for public debate**

KiwiSaver provides the framework for locked-in workplace savings for retirement. There are a number of ways that this could be expanded. Areas that ASFONZ considers require public debate include:

*Whether KiwiSaver contributions should be increased and/or made compulsory.*

The Australian experience with superannuation would suggest that the level of savings might benefit from increased levels of contribution and compulsion coupled with tax incentives to encourage long term savings (perhaps through salary sacrifice,).

Any such compulsion or incentive will need to strike a balance between the costs and benefits being borne by employers, employees and Government (through tax incentives) and consideration should be given to the impact on each of these groups. The cost to employees might be managed by exempting those on low personal incomes, or low-to-mid family incomes.

*Whether retirement savings should be subject to tax incentives.*

If so, whether those incentives should come in the form of no or lower taxes on contributions, on investment earnings or both. In either case, salary sacrifice would need to be facilitated and a contribution cap (or similar measure) considered to ensure that excessive tax benefits do not accrue to those high income earners most able to take advantage of any tax incentives.

New Zealand's Taxed-Taxed-Exempt ("TTE") approach to taxing superannuation is consistent with the "broad base - low rate" approach to tax policy. Unfortunately, the TTE approach and a rigidly-applied broad-base low-rate policy lacks flexibility to drive behavioural change and offers no incentive to save rather than consume. In our view, the TTE regime was appropriate for a retirement plan delivering pension benefits, but is inappropriate in a lump sum

environment as once the retiree has taken his or her lump sum, it is then reinvested with no “E” on such investment income. ASFONZ would encourage, and welcome, the debate to consider whether TTE is the most appropriate model for taxing locked-in retirement savings.

There is already debate around whether tax incentives change savings behaviour, and if they do whether the change increases the level of savings or merely drives substitution of one form of investment for another.

Although this substitution concern needs to be acknowledged, substitution in itself could be positive outcome. ASFONZ’s focus is on retirement savings; we consider that the substitution effect of savings should not be discarded as a valid objective. In particular, ASFONZ considers substitution from short-to-medium term products to locked-in retirement savings, such as KiwiSaver, would be favourable. It is also possible that a shift from housing assets to financial assets could be a positive outcome in the medium-to-long term.

#### *What trade-offs are acceptable*

Given Government’s need for fiscal neutrality for any incentives, it seems inevitable, and necessary, that any incentives or inducements need to be offset by a compensating increase in revenue, or decrease in spending. It is therefore necessary to consider (and debate) what trade offs might be acceptable.

Where there is a clear link between tax incentives and retirement savings, there seems to be an opportunity to offset the cost against future retirement spending. In the medium term, this could include increasing the retirement age, and, in the medium-to-long term, reducing or means testing any state-funded retirement benefit. We acknowledge that there is currently strong reluctance to change the age of eligibility of New Zealand Superannuation, but what about (fiscally neutral) allowing voluntary deferral past 65 with an increased amount granted for each month of deferral?

More immediately it will be necessary to consider what trade-offs might be available to offset the cost of incentives to save. ASFONZ is aware of public discussion of possibilities such as increasing GST or introducing a capital gains tax. Both are discussed later.

#### **Issues arising post-retirement**

At present, there are limited options available for the decumulation of retirement earnings. KiwiSaver provides for retirees to receive a lump sum, rather than an annuity or pension.

ASFONZ would strongly support an examination of the investment options that exist for retirees (their exposure to Finance Companies being a glaring example), and steps to ensure that sufficient credible products are available to support such choices.

### *Annuities in New Zealand*

The New Zealand annuity market is very limited, caused, in part at least, by the tax regime applying to annuity products – another example of the “E” not being effective. ASFONZ is aware of the rewrite of the life insurance tax regime, but understand that annuities have not yet been addressed. This needs to be considered as a matter of priority to ensure that a range of products are available for investment of funds (and have a track record to provide a degree of confidence for investors) by the time that KiwiSaver products start to mature.

The lack of depth in the available annuity products is also significant, and detrimental, to the management of longevity risk. An ageing population means that this issue will continue to take on increasing significance in the future.

### *Application of withdrawals from KiwiSaver*

Consideration should also be given to how funds are made available from KiwiSaver products. We are seeing increased trans-Tasman co-operation and co-ordination on superannuation matters (such as the portability agreement signed between the New Zealand and Australian governments). In light of this, Australia seems to be the logical place to look for precedents.

ASFONZ is attracted to the concept of allocated pensions, but we would emphasize the need for a variety of products for retirement and investment during retirement to manage longevity risk and income needs.

## **Other possible changes in tax regimes**

We understand, from media coverage, that the TWP is considering various issues including the possible introduction of capital gains tax (“CGT”) and/or increasing GST.

### *Capital gains tax*

A CGT has the potential to help substitution of housing assets for financial assets by removing the tax preference that currently exists for investment property held on capital account. Clearly, this needs to be coupled with improved understanding of, and confidence being restored in, the financial markets and funds management industry.

A CGT regime will have administration and compliance costs, and the potential to create a drag on liquidity of assets. If introduced, the design of the CGT regime should consider these costs and ensure that the benefits of the regime (whether revenue collection or shifting behaviours) are not outweighed by these costs.

New Zealand has a good track record of implementing efficient tax regimes that manage the administration and compliance costs. For example, GST was introduced with few of the boundary issues that arise in other GST regimes that offer (often politically motivated) exemptions for specific items; and KiwiSaver being implemented though the PAYE system to minimise employer administration.

For these reasons, we welcome the discussion about CGT and do not believe that such an option should be dismissed lightly.

*Increasing GST*

GST is currently imposed on all goods and services, with few exemptions. This contributes to the simplicity and efficiency of New Zealand's GST system, but also has the detrimental effect of increasing the cost of necessities of life, including basic food staples.

Although an increased GST could dampen the marginal propensity to consume, and potentially increase savings, it also risks placing additional financial strain on those with low incomes. Therefore, an increased GST could impact negatively on low-to-middle income families and retirees.

We would be pleased to discuss any of the issues raised in this paper. In the first instance, please contact Bruce Kerr.

Yours sincerely



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