

19 May 2011

The 2011 Budget heralded the next round of changes to KiwiSaver. The changes see a reduction in the tax incentives provided by the government and an increase in the minimum employee and employer contribution levels. When fully implemented, there will be advantages and disadvantages to each individual, relative to the status quo.

For the self-employed, stay-home parents and beneficiaries (i.e. non-employees) KiwiSaver is now less attractive but still beneficial. They will receive lower future MTC's (50 cents per \$1 not \$1 for \$1 up to \$521 reduced from \$1,043 a year). However, this group is still generally better off saving in KiwiSaver, than saving elsewhere, because of the MTC (member tax credits).

Employees will also benefit ultimately, but at a higher cost to them. They likewise get a reduced MTCs but eventually (from 2013) gain higher employer contributions. It is particularly beneficial for the lower paid, particularly those saving for a deposit for their first home as they cannot withdraw the MTCs, but will be able to withdraw the higher employer contributions.

Key messages

The key messages are:

- KiwiSaver remains a great way to save and better than most alternative forms of savings.
- It is better to join sooner rather than later. This is particularly true for an employee, so that they get through their first year while the minimum rate is 2%.
- The affect of the changes is that the net-of-tax employer contribution increases for all employees who are members.
- For many, KiwiSaver will still form a great base for their retirement savings. Savings above the minimum will be just as important in the future, as it was in the past.
- Saving in KiwiSaver is still more attractive for most than paying off their mortgage.

Changes - summary

The changes under the budget are:

- Tax is imposed on employer contributions from 1 April 2012.
- Member tax credits (MTCs) are reduced from those accruing from 1 July 2011 and payable from July 2012.
- The minimum 2% employee and employer contributions increase to 3% from 1 April 2013.

There are no changes to the \$1,000 kick-start, the first home deposit subsidy and the other KiwiSaver provisions.

KiwiSaver changes timeline

| | |
|--------------|--|
| 19 May 2011 | Budget 2011 |
| 1 July 2011 | MTC subsidy changes to 50 cents for \$1 up to \$10 a week (\$521 a year) |
| 1 April 2012 | Employer contributions become taxable. Only the net amount is paid to KiwiSaver |
| July 2012 | First MTC paid at the lower rate (max \$521) |
| 1 April 2013 | Minimum employee and employer contribution rates become 3%. The employer's 3% remains taxable. |



Changes – more detail

Tax on employer contributions

From 1 April 2012, the employer contributions cease to be tax-free and will be taxable under the ESCT (employer superannuation contribution tax) regime. The tax rate is based on the employee's marginal tax rate. Therefore, the current 2% minimum becomes a gross rate and the net rate will vary between 1.34% and 1.79% depending on the employee's tax rate. These rates apply for the one year transitional period.

Member tax credits (MTCs)

From 1 July 2011, the MTC rate will be reduced from \$1 for \$1, to 50 cents for \$1. Also, the maximum MTC will become \$521 a year (currently it is \$1,043). Members who want the maximum MTC still have to save \$1,043 to get the \$521 "free money". For an employee saving the 3% minimum the maximum MTC will be achieved on income levels of \$34,762 and above.

Minimum employee and employer contributions

From 1 April 2013, both the minimum employee and employer contribution rates become 3%. Remember, this does not apply to non-employees. The other employee contribution options of 4% and 8% remain unchanged.

The new 3% minimum employer contribution is gross of tax. The net rate therefore varies between 2.01% and 2.685% depending on the employee's tax rate.

The changes to the employee and employer minimum contribution rates do not affect the self-employed, stay-home parents, beneficiaries and non-working children. This group continue to be able to save at whatever level they choose.

The impact of the higher employer contribution rate and the deduction of ESCT tax mean that all employees are better off and will have higher savings from this source. The comparison of the minimum employer contribution levels are:

| Income level | Current net employer contribution rate to 31 March 2012 | Net employer contribution rate 1 April 2012 to 31 March 2013 | Net employer contribution rate after 1 April 2013 |
|--------------|---|--|---|
| \$30,000 | \$600 | \$537 | \$743 |
| \$50,000 | \$1,000 | \$825 | \$1,238 |
| \$70,000 | \$1,400 | \$980 | \$1,470 |
| \$90,000 | \$1,800 | \$1,206 | \$1,809 |
| \$110,000 | \$2,200 | \$1,474 | \$2,211 |

From 1 April 2013, the higher employer contributions benefit the lower paid more than the higher paid.

Other KiwiSaver provisions

There is no change to the kick-start and first home deposit subsidies. Also, the requirement to save for a minimum of the first year's membership, before an employee can go on a contributions holiday, remains unchanged.

With no changes to the eligibility provisions, KiwiSaver still becomes an ideal vehicle for children and non-employees. This group of New Zealanders can benefit from the \$1,000 kick-start without having to save \$1.

First home withdrawals

Because the employer contributions increase for all employees, particularly the lower paid, KiwiSaver will become a better vehicle for employees to save to help buy their first home.

For the self-employed

Currently, the self-employed tend to join and save \$1,043 a year. As a result they receive the \$1,000 kick-start and the MTC of \$1,043 a year. Those that join but choose not to save, just get the \$1,000 kick-start.

In future, the self-employed should still save \$1,043 a year but will only receive \$521. This is still a better deal than not getting the MTC. For a member with 10 years to go to retirement, the \$5,200 MTCs plus investment earnings, is a significant payback on the \$10,430 paid in by the member.

Issues for employers

The changes raise a number of issues and challenges.

The disruption of change

As a general rule, change involves time and is disruptive to the main business activities of the employer. The employer will need to assess the financial cost and the HR policy impact of the changes. The time involved to be able to make rational decisions should not be underestimated.

Budgets

Employers will need to budget for the increase in the minimum savings rate and work through the wider impact on their remuneration levels. This may mean that future pay increases are lower, as the higher KiwiSaver costs do nothing for productivity. It may also be that with the increased focus on KiwiSaver and the attractiveness of the higher employer subsidy that more employees choose to join.

Integration with current superannuation arrangements

Where an employer pays above the minimum, there may be no immediate increase in costs, but there will be lower benefits to employees because of the removal of the tax-free status of the first 2%. For employers who currently pay more than the minimum, there may be advantages in letting employees take a contribution holiday and direct all of the employer contribution to a non-KiwiSaver superannuation scheme as there is no longer any tax advantage of KiwiSaver for employer contributions. There is still potential for the employee to get the MTC.

Payroll administration

Many employers will have to change their payroll system to cope with the ESCT tax on the employer KiwiSaver contributions. As a minimum, employers will need to calculate ESCT rates for employees. This is not a straight forward exercise (see page 5). Even for those employers whose systems can already cope, there will be costs of updating employees' new contribution elections as they respond individually to the changes. Some employees who currently pay 4% will cut back their level to 3% and those on 2% will need to go to 3%. There may also be an influx of contribution holiday requests.

Communication

Employers will also have to determine how they communicate the changes to employees. To avoid negativity, it is important that the communication helps all employees understand the impact of higher employee contributions – higher employee contributions mean less take-home-pay.

Wage negotiations

Employers with a strong union involvement in their workforce, can expect, in the current rounds of wage negotiations, demands for compensation for the extra 1% payable by the union employee after 1 April 2013.

Issues for employees

Meeting the cost of the extra 1%

Employees who are getting KiwiSaver and no other superannuation, will need to budget for the extra 1%. They have 18 months to plan for this. It must be remembered that while they must save more, they receive it back at retirement or when they buy their first home. In some cases therefore, they will reduce savings elsewhere with the higher KiwiSaver savings.

KiwiSaver and non-KiwiSaver superannuation options

Employees who currently contribute more than the 2% minimum KiwiSaver contribution and have it integrated with their other employer superannuation arrangements, will need to review what they do. Also, the changes will mean that more employees can capture the MTC and government payments without locking up as much of their future savings to retirement age.

Examples

To understand the changes, below are three examples:

An employee earns \$40,000 and is saving 2%.

| Contributions year to: | 31 March 2012 (current) | 31 March 2013 (transition) | 31 March 2014+ (future) |
|------------------------|---------------------------|----------------------------|-----------------------------|
| Employee | \$800 p.a. (\$15.38 p/wk) | \$800 p.a. (\$15.38 p/wk) | \$1,200 p.a. (\$23.08 p/wk) |
| Employer | \$800 p.a. (\$15.38 p/wk) | \$660 p.a. (\$12.69 p/wk) | \$990 p.a. (\$19.04 p/wk) |

| MTC paid for year to | 30 June 2011 | 30 June 2012 | 30 June 2013 | 30 June 2014+ |
|----------------------|--------------|--------------|--------------|---------------|
| MTC | \$800 | \$400 | \$450 | \$521 |

Note: As the employee has contributed less than \$1,043 a year in the period to 31 March 2013, they could voluntarily top-up (pay extra) savings so that their total savings are \$1,043. If they do this they would receive from the government the maximum member tax credit. If a person age 18 or older saves at least \$1,043, the MTC is:

| MTC (max) | 30 June 2011 | 30 June 2012 | 30 June 2013 | 30 June 2014+ |
|-----------|--------------|--------------|--------------|---------------|
| MTC (max) | \$1,043 | \$521 | \$521 | \$521 |

An employee earns \$100,000 and is saving 2%.

| Contributions year to: | 31 March 2012 (current) | 31 March 2013 (transition) | 31 March 2014+ (future) |
|------------------------|-----------------------------|-----------------------------|-----------------------------|
| Employee | \$2,000 p.a. (\$38.46 p/wk) | \$2,000 p.a. (\$38.46 p/wk) | \$3,000 p.a. (\$57.69 p/wk) |
| Employer | \$2,000 p.a. (\$38.46 p/wk) | \$1,340 p.a. (\$25.77 p/wk) | \$2,010 p.a. (\$38.65 p/wk) |

| MTC paid for year to | 30 June 2011 | 30 June 2012 | 30 June 2013 | 30 June 2014+ |
|----------------------|--------------|--------------|--------------|---------------|
| MTC | \$1,043 | \$521 | \$521 | \$521 |

A stay-home parent or self employed person saving \$1,043 a year

| Contributions year to: | 31 March 2012 (current) | 31 March 2013 (transition) | 31 March 2014+ (future) |
|------------------------|-----------------------------|-----------------------------|-----------------------------|
| Savings | \$1,043 p.a. (\$20.00 p/wk) | \$1,043 p.a. (\$20.00 p/wk) | \$1,043 p.a. (\$20.00 p/wk) |

| MTC paid for year to | 30 June 2011 | 30 June 2012 | 30 June 2013 | 30 June 2014+ |
|----------------------|--------------|--------------|--------------|---------------|
| MTC | \$1,043 | \$521 | \$521 | \$521 |

Tax on employer contributions

From 1 April 2012, employer contributions to KiwiSaver become taxable under the ESCT (employer superannuation contribution tax) regime. This regime is complex. It approximately reflects an employee's marginal tax rate and will reduce the value of the employer contributions by between 10.5% and 33%.

The ESCT tax rates are calculated based on the sum of the employee's taxable income and the employer superannuation/KiwiSaver contributions paid, from that employer.

If the employee was employed for the full prior tax year, it is based on the actual amounts for that prior year. If they were not employed for the full year, it is based on an estimate for the current year. Employees employed part way through a tax year will have an ESCT rate often materially lower than their marginal tax rate for the balance of the year.

Only income and contributions from that employer count. Taxable income from other employers is not included. A person earning \$40,000 from two unrelated employers through two part-time jobs is taxed at 17.5% i.e. on the \$40,000 rate and not on the \$80,000 rate.

The relevant rates are:

| Income and contribution level ¹ | ESCT rate |
|--|-----------|
| \$0 - \$16,800 | 10.5% |
| \$16,801 - \$57,600 | 17.5% |
| \$57,601 - \$84,000 | 30.0% |
| \$84,001 plus | 33.0% |

¹Prior year's actual if employed for full year.
Estimate of current year in other cases.