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# Making KiwiSaver Fairer and Affordable

## BACKGROUND SUMMARY

## Introduction

Last year the Financial Services Council released its report entitled ***How to Supersize New Zealand Retirement Incomes*** on how to enable KiwiSavers on the minimum to average wage to achieve a comfortable retirement.

New Zealanders say a comfortable retirement income is about 2 times NZ Superannuation (currently $282 for each person in a couple aged over 65).

The FSC suggested:

* + **Keeping NZ Superannuation**, paid on the current formula with no income or assets test.
	+ **Moving default KiwiSaver funds into balanced or growth funds** rather than the current conservative funds which earn lower returns.
	+ **Offsetting the increased risk with guarantees** on the level of savings at retirement paid for by increased contributions from the KiwiSaver.
	+ **Levelling the tax playing field** for KiwiSaver funds compared with other forms of saving for retirement such as investing in rental property by cutting KiwiSaver fund tax rates.
	+ **Removing the annual $521 KiwiSaver Members Tax Credit** (MTC) to help fund those KiwiSaver fund tax cuts.
	+ **Stepping up KiwiSaver contributions by 1% a year** split between the KiwiSaver contributor and their employer until they reached the level required to fund a comfortable retirement.

## Making KiwiSaver Affordable for New Zealand Employees

With the FSC proposed KiwiSaver changes in place someone on around the minimum wage only would need to save 6-9% of their pre-tax income to achieve a comfortable retirement income compared with an unaffordable 13% on current policy settings.

When we released the FSC report last year we also released an Infometrics report on our scenarios to show the retirement nest eggs that would be produced assuming each set of policy changes combined with a particular KiwiSaver investment style (conservative, balanced or growth).

That analysis gave rise to two types of questions, namely:

* + What difference would the changes made have on the dollar amount that someone needed to save in KiwiSaver, and the impact of tax and fees paid over 40 years, and
	+ Would the changes be fair given that the current $521 MTC KiwiSaver tax credit is a fixed amount that would intuitively be of proportionally greater benefit to a low income earner than the benefits from the reduction in KiwiSaver fund tax rates which could favour higher earning KiwiSavers?

The April 2014 Infometrics report helps answer these questions.

## What Difference Does the FSC Changes Make for Contributions, Tax and Fees?

The tables on pages 12 and 13 show the breakdown of the reduction of KiwiSaver contributions and the reduction in the impact of taxation and fees on a person’s final retirement nest egg for someone who earned a certain level of income, over the 40 years, they were saving for retirement.

For a given level of contributions the analysis showed a consistent pattern. The most important driver of your retirement income nest egg balance was your investment style (conservative, balanced or growth).

The second most important driver was the tax you pay on the compounding returns (interest on interest) on your initial contributions and thirdly the level of fees you pay. Every dollar of tax or fees you pay is a dollar that cannot be reinvested to earn compounding returns over the balance of your 40 years of saving.

If we want to make a comfortable retirement affordable for most New Zealand employees we need to have KiwiSavers in balanced or growth funds and paying much lower tax rates within their KiwiSaver funds. Currently many people default into conservative funds and do not realise they may arrive at retirement with a nest egg considerably smaller (at least $150,000 less) than if they were saving in a balanced or growth fund. On current KiwiSaver fund tax rates, someone on an average New Zealand income will have their retirement nest egg halved by the effect of taxation on their retirement savings over 40 years.

## Fairness of the FSC Proposals

The FSC proposals were designed to address the unfairness of the current KiwiSaver tax regime.

Many in the lowest income households cannot afford to save even 3% of their income in KiwiSaver only 42.4% of 18-64 years in households earning $20,000 or less are enrolled in KiwiSaver.

For higher income households the proportion is 60 to 70%. To receive the full value of the $521 MTC a person needs to be earning an income of about $35,000 (above the median income of the working age population of around $30,000).

Higher income New Zealanders can afford to save the deposit to purchase a property for rental on which they will pay a much lower effective tax rate than someone on the same income saving in KiwiSaver. Rather than losing half of their KiwiSaver income due to the impact of tax, the effective tax rate for someone on a high income investing in a rental property geared up to 80% only loses 8% due to the impact of tax.

While intuitively it does not appear likely that giving up the $521 MTC for lower tax on KiwiSaver funds would benefit a person on a middle or lower income, Table 7 on page 12 of the Infometrics report shows that:

* ***someone on a median income can cut their KiwiSaver contributions by $141,000 and boost their retirement nest egg by $219,000 due to the reduced impact of tax even though they no longer receive the $28,000 over 40 years from the $521 MTC each year in that scenario.***

From Table 4 on page 7, by looking at the effective tax rates under the current situation compared with the FSC proposed changes you can see the effective tax rates are still progressive (the effective tax rates increase as incomes increase) and that the proposed effective tax rate for the highest income earners at 37.1% saving over 40 years is higher than the current highest marginal income tax 33% rate or KiwiSaver fund PIR 28% tax rate for someone in that income bracket, $159,500, a little above what a back bench MP is paid.

If the concern is that high income earners will save excessively close to retirement it is possible to cap the annual level of contributions that can be saved without adversely effecting access for lower income KiwiSavers.

The PIR tax rates suggested by the FSC are but one possible way of reducing the amount lower income earners need to save to fund a comfortable retirement.

A different, but still lower than current PIR tax rate structure or even keeping the $521 MTC are all options a Government could examine if it was prepared to forgo the revenue elsewhere.

***In reality, high income earners are still likely to invest in rental property rather than KiwiSaver for a number of reasons.***

Rental property investors unlike KiwiSavers don’t need to stay in that investment until they are 65. For casual rental property investors their capital gains are tax free and any losses on borrowing costs compared with their rental income are deductible against their other incomes. If their investment period in rental property is short and the rental property investment mainly funded by debt, they could even receive a tax credit or a cheque from the IRD rather than pay any tax on income from this form of retirement saving.

***If ordinary New Zealanders are to achieve a comfortable retirement saving in KiwiSaver then KiwiSaver fund tax rates need to be cut and most KiwiSavers will need to spend most of their earning years saving in balanced or growth funds.***