Policy Watch

KiwiSaver and the Tax Treatment of Retirement Saving in NZ

Susan St John #

For nearly twenty years the retirement system in New Zealand was uniquely simple, comprising just a basic state pension and voluntary unsubsidised private saving. The neutral tax treatment of retirement saving, formalised in the 1993 Accord for Superannuation, was an important counterpart to the eventual provision of New Zealand Superannuation as a fully universal basic income. This paper reviews how tax neutrality was introduced, how it was undermined and finally abandoned in 2007, and questions whether the next New Zealand tax experiment is well grounded.

Key words: Tax neutrality, Tax concessions, Retirement saving, Annuities, Retirement policies.

1. Introduction

For nearly twenty years, New Zealand adhered to the principle of tax neutrality for private saving. Tax concessions for retirement saving had been removed between 1988 and 1990, along with other wide ranging reforms to the tax system (St John & Ashton 1993). Voluntary, unsubsidised private saving together with a universal state pension, New Zealand Superannuation, appeared to be a well-supported, cost-effective, adequate, and highly equitable approach to retirement incomes policies.

In 2007, this radical experiment was brought to an abrupt end with the reintroduction of tax incentives associated with KiwiSaver, a voluntary

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private contributory saving scheme. By effectively abandoning the framework of comprehensive income tax, New Zealand has returned to the complexities, inefficiencies and inequities of a hybrid approach for taxing returns to capital thought to be so damaging in the 1980s both in New Zealand and in many other OECD countries (Hagemann, Jones, & Montador, 1987; Stiglitz, 2000).

2. Comprehensive Income Tax

In the 1980s, special tax advantages in the tax system were supposed to achieve all kinds of objectives. The subsequent narrowing of the base implied a higher rate was required to raise sufficient revenue. In turn, higher tax rates increased the incentive to evade and avoid or otherwise find loopholes, and for interest groups to lobby for further protection.

In this environment the tax system (as in other OECD countries) was widely perceived to be complex and administratively cumbersome, to have high efficiency costs and to be inequitable (Hagemann, Jones, & Montador, 1987; McCaw Committee, 1982; McLeod, 2001b).

2.1 Tax reform 1987-1990

The necessary process of tax reform began in the mid 1980s. In December 1987, the Minister of Finance, Roger Douglas, proposed a low flat rate of personal tax aligned with the company rate. Tax subsidies for saving were to be removed, imputation credits introduced for dividend income and the tax base broadened by the closure of loopholes of all kinds. The rationale was largely economic and there did not appear to be any particular concerns about the effects on retirement incomes. The intent was to ‘level the playing field’ so as to remove, or minimise, the economic cost of distortions that arose from treating different income streams differently. Douglas argued that tax concessions had allowed savings to flow to favoured financial institutions that had not invested the money in the best ways possible for growth. He claimed that a low, flat tax rate was necessary to encourage saving, reward work and minimise avenues for income splitting. The intent was clearly to underpin the other economic reforms of the 1980s in New Zealand that had emphasised the role of the free market in the allocation of scarce resources (Easton, 1997a, 1997b).

A consultative document reviewed the arguments for the comprehensive income tax approach that lay behind these reforms, particularly as they

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1 This section draws on St John (2007) and Ashton & St John (1993)
affected saving. In particular the alternative of a direct expenditure tax (DET) was considered. DET has the theoretical advantage of not imposing a penalty on saving. The DET base is income (Y) less saving (S) or (Y-S). It was noted that if savings are positive the DET base is smaller than the income base (Y), necessitating higher rates of tax to achieve the same revenue. In turn, higher rates of tax carry higher disincentives to work, offsetting the advantage in not taxing saving (Douglas, 1988).

A comprehensive income tax rather than a DET was chosen in light of these and other difficulties including the lack of experience with DET in other countries (Douglas, 1988, p. 38).

2.2 Tax treatment of saving

Prior to the tax reforms of the late 1980s, pension schemes had received preferential tax treatment on both employee and employer contributions and on fund earnings. While pensions were taxed as income, up to 25 percent of pension savings in these schemes could be taken as a tax-free lump sum. Pure lump-sum schemes were also tax subsidised, but less generously since the early 1980s.

Under the tax regime introduced in 1987 and applying until 2007, contributions to savings plans are made out of after-tax income so that contributions may be described as ‘taxed’ (T). Income accruing as fund earnings is taxed (T) at the company rate of 33%, while withdrawals from the fund are exempt from tax (E). The traditional expenditure tax treatment involves an Exempt/Exempt/Taxed (EET) regime while the reformed New Zealand income tax treatment of savings involved a Taxed/Taxed/Exempt (TTE) regime.

By 1st April 1990, the new tax regime was fully operational with the Income Tax Amendment Act 1989 and the Superannuation Schemes Act 1989 providing the necessary taxation and supervisory legislation. Schemes became ‘registered’ by the Government Actuary rather than ‘approved’ as previously for tax concession purposes. The regime emphasised the responsibilities of trustees and applied equally to schemes sponsored by employers and those offered to the public via retail schemes.

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2 If all bequests are counted as expenditure, the DET is equivalent to a Lifetime Income Tax, in turn, superior to an annual income tax, see Stiglitz (2000).

3 The concessions on life insurance and superannuation schemes alone were worth 2.5 percentage points on basic tax rates, or about 1.2 percent of GDP (Douglas, 1987). For a discussion of the pre-reform tax treatment see St John & Ashton (1993, pp. 23-24).
From this point New Zealand’s tax regime for retirement income saving no longer distinguished between pension and lump-sum schemes. A tax neutral approach precludes the right to regulate retirement saving for social purposes, for example, to legislate for the purchase of an annuity from the retiree’s lump-sum savings. Thus with no tax concessions, no restrictions could apply as to how scheme benefits were to be received, although the trust deed could specify such details. Rather than tight regulation, the disclosure requirements of the Securities Amendment Act 1996 and the Investment Advisors (Disclosure) Act 1996, were imposed, consistent with free market reforms that are based on provision of full information (Periodic Report Group, 1997, p. 191).

These far-reaching reforms made New Zealand the only OECD country, except perhaps Mexico, not to tax private savings for retirement differently from other forms of saving (Yoo & de Serres, 2004).

2.3 The transition to tax neutrality

A complex and uncertain time for private superannuation followed the December 1987 announcement of TTE. A transitional regime for previously tax-favoured schemes was supposed to be sufficient to allow the smooth adjustment to the new tax environment.

A consultative committee under the chairmanship of Dr Donald Brash recommended an approach that exempted contributions from tax, but fully taxed fund earnings and emerging pension benefits (Exempt/Taxed/Taxed). They claimed this would be more appropriate and less costly and yet still achieve tax neutrality (Report of the Consultative Committee, 1988). Nevertheless, the Government proceeded with the TTE treatment of superannuation saving.

There was little over two years between the announcement of the new regime and its full implementation. All pension schemes had to be reviewed, and pension levels could be reduced to reflect their new tax-paid status and to allow for the tax on investment income. Many occupational schemes were closed to new members, while others were wound up and the funds distributed. Some were changed from a defined benefit basis to a defined contribution basis.

Existing schemes were permitted to reduce accrued benefits to compensate for the new tax regime. Existing and newly retiring pensioners were to be compensated for the tax on fund earnings and the subsequent reduction in their pensions by being able to take the pension tax-free.

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4 For more details see St John & Ashton (1993)
There was widespread misunderstanding concerning the effect of tax-free pensions on final disposable incomes and why pensions had to be reduced. The renegotiation of the defined benefit state sector scheme, the Government Superannuation Fund, was particularly acrimonious, with many members seeing the reductions in their benefits as a unilateral attack on their living standards and contractual rights (St John & Ashton 1993).

As it turned out, many schemes in actuarial surplus did not reduce the pensions already being paid much if at all so that pensioners received an immediate increase of disposable income from their pensions of up to 49 percent depending on their marginal tax rate. The Government Superannuation Fund (GSF) was also required to reduce benefits, despite being largely PAYGO. In this case, existing pensions were reduced as if the pension was taxed as primary income ignoring all other forms of income. There were considerable windfall gains for those on the highest marginal tax rate and with the largest pensions (St John & Ashton, 1993, p.39).

Not only were the distributional consequences of adopting TTE unfortunate, but the loss of tax revenue was scarcely appropriate in the light of the fiscal problems the Government was facing in 1990. It was estimated that the revenue forgone over time by the granting of tax-free benefits to those who had saved under a highly tax concessionary regime was of the order of around $3-4,000 million in present value terms (Report of the Consultative Committee, 1988).

The net result of the renegotiation period was that many of those who had already benefited from the concessionary regime of the past benefited yet again. What had been an EET regime became, effectively EEE for some. A one-off tax on accrued capital might have been effective in reducing the windfall gains, as was suggested when similar possible reform was considered in the US (Munnell, 1992).

Douglas argued that long drawn out transitional arrangements are seldom fair, they are usually complex, and they defer the benefits of the changes being implemented. He believed that any dramatic change in which there are winners and losers was best presented as part of an overall package where personal losses in one area are offset by gains in other areas. But political factors disrupted the reform process so that many of the changes originally envisaged by Douglas were not implemented. The full reduction in personal taxes never eventuated as the government backtracked from flat tax, and some other significant features of the wider reforms, including a capital gains tax were also abandoned.

The timing of the reforms could hardly have been worse. The December 1987 announcement came just after the New Zealand share market crash and at the beginning of what was to be a prolonged and deep economic
recession. Reduced cash flows and the attempts to shift towards more liquid portfolios on the part of major long-term savings institutions intensified the downturn in the property and equities market. Unlike many other countries, share prices were slow to recover after the share market crash, and the share price index (Barclays Index) fell from a peak of 3,800 in October 1987 to around 1,200 by the end of 1990. Attempts to sell assets by institutions in this period may have contributed to the damagingly high interest rates that persisted despite a rapidly reducing rate of inflation. The Consultative Committee had certainly foreseen this possibility as a consequence of the new tax regime (Report of the Consultative Committee, 1988, p 26).

The prize from this painful, costly, far-reaching reform was to be freedom for the individual to save in whatever form was appropriate to their circumstances; this could include repaying the mortgage, investing in their education or business, or in financial assets. A lower tax rate on a wider base was expected to encourage work and saving and economic performance generally.

2.4 Backtracking from flat tax

The tax regime adopted by New Zealand (TTE) for retirement saving works best if the tax rate system is fairly flat. That way, the contributions tax rate applied to employer contributions, the tax rate on fund earnings (the company rate) and the marginal tax rate of contributors will be similar. No end of year reconciliation is required nor is the imputation of income from tax-paid funds. However Douglas’s radical and unexpected announcement in late 1987 caused much political bickering within the government, and the flat tax proposal was abandoned. Instead, two statutory rates with a low income rebate were introduced giving three effective marginal tax rates (see Table 1).

<table>
<thead>
<tr>
<th>Bracket</th>
<th>Effective marginal tax rate % 1988-1996</th>
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<tr>
<td>$0-9500</td>
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<td>$9501-30895</td>
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<td>$30,895-38,000</td>
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<td>$60,000+</td>
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* Includes the low income earner's rebate
Nevertheless until the mid-1990s, the tax scale was fairly flat and the tax regime of TTE worked tolerably well. But once the second tax band was lowered from 28 percent to 21 percent and extended, there were big disparities between taxes paid in superannuation funds and the marginal rates actually faced by low and middle income earners. Employer fund contributions (under a withholding tax, the SSCWT\(^5\)) and earnings in the fund were taxed at 33 percent making the regime tax penal for anyone on only a 21 percent tax rate.

Perversely however, significant tax advantages from saving in employer-sponsored schemes for high-income superannuation fund members were introduced when the top tax rate was lifted to 39 percent in 2000/1 (see Table 1). Despite the best endeavour of the Taxation of Life Insurance and Superannuation working party, TOLIS (1997), to resolve the marginal tax rate issues, there were no easy answers in determining a suitable proxy rate for either employer contributions, or for the taxation of fund earnings. In 2004 a partial solution was introduced so that employers could use the marginal tax rate of the employee (15%, 21%, 33%) for the tax on employer contributions. The option was voluntary and did not address the over-taxation of fund earnings for employees on tax rates of less than 33 percent.

In another tilt to the playing field, superannuation funds paid tax on capital gains where such funds are deemed to be trading assets rather than investing 'passively'. Individuals who invest on their own account are usually exempt from such a tax. In 2004, a report commissioned by government to determine an acceptable tax treatment recommended the removal of capital gains tax on non-passive managed funds to address this anomaly (Stobo, 2004). The government included this as part of the overall tax changes for investment vehicles to take effect in 2007 as discussed below.

2.5 The ‘level playing field’?

After the radical reforms undertaken in the 1980s, the NZ tax system has long been regarded as one of the most efficient within the OECD (OECD, 2007).

While the OECD has consistently endorsed the New Zealand approach to tax reform, in recent years it has criticised the lack of a capital gains tax. Housing, especially, has remained tax favoured. Since the tax changes in

\(^5\) Specified Superannuation Contribution Withholding Tax
1990, the value of housing assets has increased markedly relative to net financial assets (Bollard, 2004).

Significant biases towards investment in housing arise from the non-taxation of the imputed rent in owner-occupied dwellings, the tax-free nature of most capital gains by individuals deemed not to be traders, and the tax regime for rental income that allows deductibility of full nominal mortgage interest and other write-offs such as depreciation\(^6\), while capital gains are largely untaxed. Despite the best endeavours of the 2001 Tax Review (McLeod, 2001a, 2001b) that examined the case for taxing imputed rent and discussed advantages that might flow from a tax on net housing equity, the Risk-Free Return Method (RFRM), there has been little political interest in levelling the playing field for housing.

### 3. Re-introduction of tax incentives?

Numerous retirement policy review taskforces during the 1990s and 2000s supported the voluntary, tax unsubsidised retirement savings regime in New Zealand.\(^7\) The 2001 Tax Review, the first since 1982, also recommended that tax incentives for saving should not be introduced (McLeod, 2001b). Nevertheless, anxiety persisted about whether New Zealanders save enough, either individually for retirement, or as a nation. New Zealand’s heavy reliance on foreign savings with a persistently large current account deficit and accumulated overseas debt\(^8\) brought New Zealanders’ poor personal savings habits under increasingly scrutiny.\(^9\)

In 2001 the Government reviewed the basis on which private savings are taxed or otherwise encouraged within the parameters that:

> ...any incentives would have to meet the requirements that they were fiscally affordable, did not crowd out other government spending and added to overall savings levels, rather than merely shifting the form of savings’ (Cullen, 2001).

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\(^6\) Recovered on resale


\(^8\) The current account deficit for the year ended March 2007 was $13.9 billion (8.5 percent of GDP), New Zealand’s net international liability position at 31 March 2007 was $145.0 billion, 85% GDP (Statistics NZ, [http://www.stats.govt.nz/default.htm](http://www.stats.govt.nz/default.htm)).

\(^9\) See, for example, Skilling, (2005).
A range of complex suggestions was made. The Minister of Finance, Dr Cullen initially proposed a ‘parallel option’ to the current taxation regime for superannuation, under which contributions continue to be paid from taxed income, investment earnings are tax free, and benefits are partially taxed. This was referred to as TET (or Taxed, Exempt, and partially taxed) compared to the current TTE. There was to be a limit on the annual contributions and a limit on the amount that could accumulate within the scheme. The scheme would be required to lock in the benefits for a period or until a specified age is attained and to provide a portion as a pension.

There were concerns in the industry that compliance would be difficult and would require new schemes distinct from existing schemes.

A report of officials noted that it was difficult to ascertain the exact goals the government wanted to achieve and that none of the options they examined (TET, TET, TET) was able to meet all the outcomes the government sought (The New Zealand Treasury, 2001). As in the past when tax incentives were considered, it has been difficult not to conclude that the advantages are likely to go to the people who least need an incentive to save, and that overall savings are unlikely to be increased. The skewed distribution of financial saving towards the higher income end persuaded the officials that tax concessions would be both highly regressive and ineffective.

On balance, the Treasury report implied that if the government really wanted to reintroduce a tax incentive, then a very limited one (with a cap on contributions of $1000-2000) with an upfront incentive would have “fewer harmful distortions to investment patterns” (The New Zealand Treasury, 2001, p. 1).

Of course a small incentive would be largely ineffective, while a large one would be not only ineffective, but also unfair and costly. In the 2002 May Budget, the government endorsed the status quo of no upfront tax incentives, and later went on to win the election.

While it appeared that tax concessions were not on the agenda in 2003 the Minister of Finance signalled his dissatisfaction with the ‘total remuneration’ packages that had become more common suggesting that “the hands-off approach works against some of that total remuneration going into long term saving”. (Cullen, 2003).

In mid 2004 the government appointed a working group to report on the design of a generic workplace savings product (Savings Product Working Group, 2004). There were many difficult issues, such as whether there should be automatic enrolment, how part-time and casual workers might be included, rules around early withdrawal, management and approval of schemes and how all this could be achieved in a tax neutral environment.
While the working group assumed that the government would not introduce any tax incentives for the generic product, it was clear that ‘sweeteners’ as they are called in the report were likely to be necessary. Critics such as the Association of Superannuation Funds of New Zealand argued that any such incentives would undermine existing employment-based schemes and would be a costly mistake, both ineffective in substantially increasing saving and cumbersome to administer.

4. KiwiSaver Mark 1

The predicted economic slowdown of the mid-2000s failed to materialise as the sustained housing boom, fed by the willingness of banks to borrow abroad, kept confidence high. Monetary policy was relied on to contain the economic boom. As interest rate rose, the exchange rate rose, exacerbating the current account deficit and increasing overseas indebtedness. There were evermore strident calls for households to save more.

The 2005 budget announced that a work-based scheme KiwiSaver, requiring a 4 percent or 8 percent employee contribution, would be introduced in 2007. The key premise of KiwiSaver (Mark1) was that people are more likely to commit to saving regularly if they are automatically enrolled rather than deciding whether to ‘opt in’.

In KiwiSaver (Mark 1), the only government subsidies were a flat $1,000 ‘sweetener’, and an annual fees subsidy of $40. These subsidies eschewed the problems of the regressivity of tax concessions and the TTE tax regime remained unaffected. The legislation was subject to the normal submissions through the select committee process but when the bill was finally reported back, some key features of KiwiSaver had been changed. Of particular significance, it had been decided that employer contributions that matched employee contributions up to 4 percent of gross income would be exempt from the withholding tax (SSCWT). The legislative effect for this was not in the KiwiSaver Act 2006 itself but in the Taxation (Annual Rates, Savings Investment, and Miscellaneous Provisions) Bill, going through the House at the same time, and appeared to be the result of compromise in a Mixed Member Proportional (MMP) parliamentary system.

Cabinet papers released under the Official Information Act show alarm bells were ringing:

10 See for discussion of this feature St John & Littlewood, (2006)
Officials do not recommend exempting employer contributions to KiwiSaver from SSCWT. On the one hand, this would create benefits for an employee to sacrifice his/her salary or wages in exchange for an employee contribution, higher amounts could be saved and compliance costs for employers would be reduced. On the other hand, this would create a tax distortion in favour of employer contributions to KiwiSaver relative to existing schemes, could have a fiscal cost of up to $330 million, could lead to pressure to exempt all employer contributions, and would lead to no tax on employer contributions under the taxed/taxed/exempt (T/T/E) model (Inland Revenue Department, 2006).

Very similar concerns were expressed by the OECD (Mourougane, 2007). Exactly as would be predicted, the employer contribution tax break was the thin end of the wedge. Reflecting the pressure from the industry, almost immediately, a further Supplementary Order paper extended similar tax privileges to all employer superannuation schemes that met lock-in provisions. Cabinet papers acknowledged that the extension to other schemes had little to do with the goal of increasing new saving as it essentially subsidised existing saving.

While there appeared to be little, or no, in depth analysis of the regressivity of the reintroduction of tax incentives, the IRD noted that the higher the employee’s salary the higher the benefit, and that:

'...the benefit of the $1000 government contribution to KiwiSaver and the fee subsidy pale over time in comparison with the benefit of the tax exemption (Inland Revenue Department, 2006).

Officials were clearly concerned about their potential cost:

The fiscal risks of a wide extension of the SSCWT exemption and other KiwiSaver incentives are very considerable (Inland Revenue Department, 2006).

A housing subsidy had been made available through KiwiSaver for first home buyers, but in addition a mortgage diversion scheme was also introduced late in the piece despite select committee scrutiny that had rejected it. Under this scheme, after one year, up to half of the employee’s
own KiwiSaver contributions can be directed to mortgage repayment. Given that a key concern that promoted KiwiSaver in the first place was overinvestment in housing, providing mortgage repayments from what was intended to be retirement savings appeared somewhat counterintuitive (OECD, 2007).

The introduction of KiwiSaver was timed to coincide with the reform of the taxation of collective investment vehicles including superannuation schemes. The intent was to retain the tax-paid nature of superannuation schemes, but to align the proxy tax rate more closely with the tax rate of the individual investor. Unfortunately as the previous TOLIS exercise showed, there is no easy way to do this accurately without imputation and an end-of-year reconciliation. The final legislation reflected this dilemma, erring on the side of generosity to the high income individual and thus opening the gates to avoidance activity (Retirement Policy and Research Centre, 2007).

Superannuation schemes (and other collective vehicles) can, from 1 October 2007, become ‘Portfolio Investment Entities’ (PIEs), where a member who earns under $38,000 from other sources but whose total income including PIE income is under $60,000 can opt for a 19.5 percent rate. In effect this could mean $60,000 of PIE income can be taxed at only 19.5 percent. If the member earns more than $38,000 in taxable pay, or more than a combined $60,000 including the PIE income, the whole of the PIE income is taxed at the alternative higher PIE rate, set at 33 percent, (30 percent from 1 April 2008). Thus there are not inconsiderable rewards for restructuring the way in which earned income is received (Retirement Policy and Research Centre, 2007).

The avenues for avoidance of tax have other ramifications which are likely to emerge over time. For example, the ability and incentive for employees to salary sacrifice into superannuation schemes generally, together with the lack of full accounting for PIE income, means that eligibility for income-tested supplements may be enhanced. For instance, an extensive programme of Families Tax Credits now applies a long way up the income distribution, providing a further 20 percent return on a salary sacrifice arrangements. A lower repayment of student loans which are now interest-free gains another 10 percent.

4.1 KiwiSaver Mark 2

In early 2007 it was clear that the pressure to extend tax concessions further would intensify. In the May Budget (just 6 weeks before KiwiSaver was to

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11 The legislation is to be finalised in late 2007. For the latest version of KiwiSaver see http://www.treasury.govt.nz/kiwisaver/
begin) tax subsidies were dramatically extended so that the first $20 a week of individual contribution attracts a matching $20 ‘tax credit’. This corresponds to a 100 percent subsidy on 4 percent contributions from gross pay up to $26,000 per annum. The tax credit is not limited to those in employment and can be accessed by beneficiaries, unpaid caregivers and the self employed for contributions up to $20 a week.

From 1 July 2008 compulsory employer contributions of 1 percent rising to 4 percent of employee’s gross pay in 2011 will apply. This is only for those employees in the scheme, leaving much confusion as to what will happen with remuneration packages and wage negotiations. The employer costs are offset by a matching $20 tax credit, so that in the first two years the cost to the employer is minimal, even when employees are earning more than $26,000, but aspects are still to go through the legislative process. Meanwhile, the top rate of the PIE regime reduces to 30% from 1 April 2008, creating an ever bigger gap between the top income tax rate and the tax on investments in PIEs.

While the new matching tax subsidies which apply to the first $20 contributed by the employee and the tax offset to the employer are less regressive than pure tax exemptions, the cost is high. The New Zealand Treasury estimates that by 2011, the fiscal cost of KiwiSaver will now be $1.2 billion, while, alarmingly in view of the stated aims of the policy the effect on household saving is expected to be only $1.1 billion (The New Zealand Treasury, 2007).

4.2 The implications
As was the experience with tax concessions in the 1980s, those for KiwiSaver can be expected to be highly regressive despite the use of a tax credit approach.12 Gains from the post-2007 regime are likely to be largest for the 45-64 age group, who are the most likely to have other savings that they can shift into KiwiSaver, most likely to benefit from the PIE regime and salary sacrifice, have the least time to wait before getting access at 65, and will still receive the universal NZS. The net present value of the upfront $1000 and the $40 subsidy on the first $20 saved is much lower for those aged 18-45, who must wait to access it until age 65. This group is far less likely to join KiwiSaver and enjoy access to the subsidies.

Subsidised KiwiSaver contributions overturn the old rule that reducing debt is the first main preparation for retirement. It now can make financial

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12 A detailed distributional analysis has not been released by Treasury or the IRD. It can be expected that high income households will gain markedly from the tax subsidies compared to low income dual or single income earners.
sense to either not reduce debt, especially student loan debt, or even to increase debt to join KiwiSaver. In terms the stated problem of low national saving (high Current Account Deficit (CAD) there has been no clear analysis of how KiwiSaver can actually help, either in theory or in practice.

In terms of the impact in an ageing society, the new regime has no constraint on the use of tax-subsidised lump-sums and offers no retirement decumulation product that might protect against the longevity risk. The fiscal costs of an ageing population have been exacerbated without securing the social goal of actual income enhancement (St John, 2006).

5. Discussion and conclusion

The direct and indirect costs of moving to a TTE regime in the late 1980s were high. The rewards of simplicity and fairness were only partially realised however because housing remained tax-advantaged, and saving in superannuation schemes was often treated inappropriately at the individual level. Speculation in housing contributed to current account worsening and a high overseas indebtedness, fuelled in turn by high interest rates and an overvalued exchange rate. In a scramble to address this problem, together with an unwillingness to confront the housing market directly, the previous highly principled approach to tax matters was relegated to second place.

The 2007 OECD report on New Zealand offered two clear alternative directions for tax reform: either comprehensive income tax or a Dual Income Tax (DIT) in which capital is taxed less than income to overcome the savings disincentive of an annual income tax (Mourougane, 2007). Both require a consistent comprehensive definition of capital income and a uniform rate of tax. Neither of these two approaches is now the basis of tax policy in New Zealand.

Perhaps a key lesson from the New Zealand experiment is that a comprehensive income tax approach to retirement saving requires that the principle be implemented comprehensively so that housing investment, in particular, does not remain tax advantaged. Failure to achieve neutrality across all classes of saving can lead to an unbalanced asset mix. But opening the door, even just a little, to tax breaks for retirement saving leads quickly down the slippery slope towards an expenditure tax treatment for retirement saving and the complexities of a hybrid approach to taxation.

Thus pressure for further changes can be expected. For example the self-employed can be expected to want the equivalent of the employer subsidies. Employees may argue that since employer contributions are tax exempt employee contributions should also be tax exempt. Compulsory employer
contributions for employees enrolled in KiwiSaver complicate remuneration policy and may lead to demands for full compulsion over time. Concessions on fund earnings in PIEs for 39 percent marginal taxpayers may lead pressures for similar tax breaks for lower marginal tax payers.

The current form of KiwiSaver exacerbat es the fiscal costs of an ageing population. To date, the government has been keen to stress that New Zealand Superannuation is secure and that KiwiSaver is a supplement that will help people be better off in retirement. However the private savings of the well-off will now be tax-subsidised so that their right to also have a generous universal tax-funded pension may be questioned.

In a document released post the 2007 Budget, Treasury re-iterate their concerns about the fiscal and efficiency costs of tax concessions. However they justify their introduction with a “least regrets” argument:

This judgement for further or stronger action rests on a least-regrets approach in the light of data uncertainties, persistent macroeconomic imbalances and the possibility that individuals are basing saving decisions on long-run expectations that could turn out to be mistaken... One possible bias is people’s probable lack of awareness of the fiscal strains that are likely to appear in the long term as the New Zealand population ages. If trends do not change, these strains could mean that programmes like NZS may have to become less generous in the future (New Zealand Treasury, 2007).

The argument that long-term fiscal strains undermine the case for continuing NZS in its present form provides a quite different rationale for KiwiSaver. And, with circularity, because KiwiSaver exacerbates fiscal pressures, it becomes itself a reason for cutting NZS. Are we witnessing the end to a bold experiment, not only in tax but also in retirement incomes policy for which there may be at least a ‘few regrets’?
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