THE TREASURY
Kaitohutohu Kaupapa Rawa

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To: Minister of Finance (Hon Grant Robertson)

Deadline: None
(if any)

Aide Memoire: KiwiSaver Distributional Scenarios - Taxing Share Gains and TWG Recommendations

This Aide Memoire responds to a request from your office for distributional information that shows how the recommendations in the Tax Working Group (TWG) Final Report will affect the build-up of balances in KiwiSaver accounts, compared to the status quo.

In response to the request, officials have prepared stylised scenarios that can be used for illustrative purposes. These scenarios have been prepared under time pressure and should be interpreted with caution.

Actual KiwiSaver investment returns are likely to differ from the returns assumed in the scenarios. The tax treatment of returns will also differ depending on the form of the returns, under both status quo policy settings and the TWG's recommendations.[1]

A general observation is that for lower income savers, their net benefit increases over time, as the relatively large benefit of the higher member tax credit and lower employer superannuation contribution tax increases compounding investment returns. For higher income savers, the benefits of subsidies to contributions initially give them a net benefit, but over time the higher tax on a larger portfolio of Australasian shares gives them a net cost.

Assumptions

Officials have illustrated stylised investment returns for four hypothetical savers – persons earning $48,000, $62,000, $100,000 and $200,000 per year. For simplicity, they are presumed to earn the same income every year. While assuming no wage growth is not realistic, it is consistent with how officials and the TWG have previously reported on KiwiSaver distributional issues. It also makes the benefits to lower income savers more apparent.

[1] For example, capital gains on Australasian shares, returns on other foreign shares, and returns on debt investments are all taxed in different ways under both status quo policy settings and the TWG's recommendations.

Officials have modelled contributions and earnings over 30 year and 45 year periods. This is similar to distributional analysis of KiwiSaver options that was previously provided to the TWG (which the TWG published in the Interim Report), and that has also been provided to you (T2019/297; IR2019/081 refers).

- **Contributions** – savers are assumed to contribute 3% of their pre-tax income to the fund each year, and their employer is assumed to contribute a matching 3% contribution. Employer superannuation contribution withholding tax (ESCT) is withheld from the matching contribution when applicable. The applicable member tax credit is contributed by the Government.

- **Investments –** 15% of new contributions are invested in Australasian shares, and the remainder are invested in other investments.[2] The portfolio is rebalanced every year to maintain a 15% portfolio allocation in Australasian shares.

- **Investment returns –** Capital gains on Australasian shares are presumed to be 3.7% per year, which is the average annual gain for domestic shares over the last 20 years.[3] Dividends on Australasian shares are assumed to be 5% gross (inclusive of imputation credits). All other investments are presumed to earn a 5% taxable return.

- **Relevant KiwiSaver and tax rules** – the following bullets describe how KiwiSaver and tax settings would change if the TWG's recommendations were adopted, and how these changes would affect different scenarios:

  - **Member tax credit** – the member tax credit is currently a maximum of $521 per year. Under the TWG's recommendations, the member tax credit would change to a maximum of $781.50 per year. *This recommendation affects all scenarios*.

  - **ESCT** – ESCT currently applies to all KiwiSaver employer contributions under a progressive rate schedule. Under the TWG's recommendations, ESCT would be rebated to the fund for persons earning up to $48,000 per year and partially for persons earning above that amount. *This recommendation affects the scenarios for the people earning $48,000 and $62,000.*

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[2] This is the average allocation of investment into Australasian shares according the 2018 KiwiSaver annual report published by the Financial Markets Authority.

[3] For the revenue costing, we assumed 3% annual appreciation in share values. That was chosen out of a principle of conservatism given inherent volatility in share prices. As this aide memoire is illustrating the potential cost to KiwiSavers of taxing the gain, it is conservative to use the higher historical average amount. This will also make it more comparable to analyses in the private sector that are likely to use a similar appreciation assumption.

- **Taxation of investment income** – This is effected through the portfolio investment entity regime, which applies a progressive rate to the investor's share of the fund income. Under the TWG's recommendations, the rates lower than 28% would be reduced by five percentage points each. *This recommendation only affects scenario for the person earning $48,000.*

- **Taxation of capital gains on Australasian shares** – currently, these gains are not taxed. Under the TWG recommendation, these would be taxable like other investment income earned by the fund.[4] *This recommendation affects all scenarios*.

The calculated KiwiSaver balances are set out in the tables in the Annex.

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[4] Shares in other foreign companies are taxed under the fair dividend rate and there is not TWG recommendation to change that.

Annex: KiwiSaver balances after 30 years and 45 years

Saver earning $48,000 per year

New Law: Balance after 30 years	$ 249,068	
Old law: Balance after 30 years	$ 207,345	
Difference:	$ 41,723	20%

New Law: Balance after 45 years	$ 589,567	
Old law: Balance after 45 years	$ 481,207	
Difference:	$ 108,360	23%

Saver earning $62,000 per year

New Law: Balance after 30 years	$ 240,500	
Old law: Balance after 30 years	$ 221,088	
Difference:	$ 19,412	9%

New Law: Balance after 45 years	$ 518,969	
Old law: Balance after 45 years	$ 485,439	
Difference:	$ 33,350	7%

Saver earning $100,000

New Law: Balance after 30 years	$ 343,034	
Old law: Balance after 30 years	$ 337,273	
Difference:	$ 5,761	2%

New Law: Balance after 45 years	$ 740,224	
Old law: Balance after 45 years	$ 740,295	
Difference:	$ (71)	0%

Saver $200,000

New Law: Balance after 30 years	$ 640,487	
Old law: Balance after 30 years	$ 643,023	
Difference:	$ (2,536)	0%

New Law: Balance after 45 years	$ 1,382,092	
Old law: Balance after 45 years	$ 1,410,970	
Difference:	$ (28,878)	-2%