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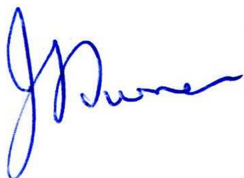
2013 Review of Retirement Income Policy: submission

The GSA is concerned that any income retirement review should emphasise the life-time commitment that retirement income provisions represent, and in that context we would refer you to the attached submission made recently to the Parliamentary Commerce Select Committee in support of a petition seeking equity in the taxation of Government Superannuation Fund annuities. Rob Cameron's report on the development of capital markets drew attention to the unfavourable taxation treatment of annuities generally (page 92 –Capital Market Development Taskforce) and the deleterious effect this has on persons seeking to make provision for their retirement. This will become increasingly important, when, with the scheme in place for longer, KiwiSaver beneficiaries obtain larger sums on retirement.

When contributors sign up to a retirement income scheme they expect the party with whom they treated, in our case the Crown, will take a long term view and not ignore inequities that arise from subsequent policy decisions or legislative changes. In the case of GSF and NPF annuities, the original decisions on taxation (or in the case of GSF and NPF annuities, a "reduction factor" imposed in lieu of taxation) were made in 1990, but substantial reductions in taxation since then have benefitted the community widely, but have not been passed on to GSF members.

Long term certainty and equity must be the hallmark of retirement income policy if it is to have credibility and support from all citizens. We are awaiting the report from the Select Committee and the Government's response, but we would like your report to acknowledge the necessity of the equitable treatment of annuities. Taxation provisions should not adversely affect those who have contributed for their working lives but find themselves in retirement subject to higher effective levels of taxation than the community at large.

We can provide additional information if you wish.



Jim Turner
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Government Superannuitants Association

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Submission on the petition to the House of Representatives:

That the House of Representatives call on the Government in its role as employer to adjust the annuities payable to members of the Government Superannuation Fund and the National Provident Fund to reflect taxes applicable in 2011 rather than the currently reduced annuities that reflect 1990 taxes.

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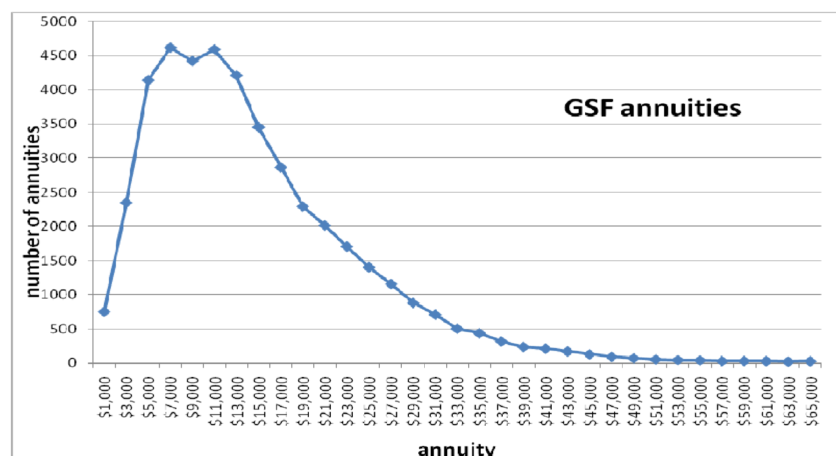
25 August 2011

To the Commerce Select Committee

Background

1. Around 70,000 government employees past and present are receiving an annuity from the Government Superannuation Fund (GSF) or the National Provident Fund (NPF), or are still contributing to these schemes. The GSF and NPF schemes were closed to new entrants in 1992. The Government Superannuitants Association (GSA) has represented government annuitants since 1920 and has 25,400 members.
2. Membership was encouraged and for a period was compulsory, and the existence of the scheme was taken into consideration in setting pay in the public sector. Each member of these defined benefit superannuation schemes makes a regular payment from salary throughout his/her working life (usually at 6.5% of salary) to provide an annuity on retirement for life, and a payment of half that annuity to a surviving spouse. Other provisions relate to dependants and capitalisation of up to a quarter of the annuity.
3. Membership of one of these schemes represents a lifetime contract between the individual contributor and his/her employer, the Government. By this means, many government employees have saved for their retirement.
4. GSF annuity levels in 2011[1] are:
   a. Lower quartile: $7,000
   b. Median: $12,500
   c. Upper quartile: $21,000

   These are annuities reduced by a factor set in 1990 in substitution for tax.



5. The annuity is paid from the accumulated employee contributions, investment earnings on those contributions, and the deferred employer contribution. Because the employer contribution to the GSF is deferred, the scheme is not fully funded, but the GSF Act guarantees the payment of the annuity, which is based on the period over which the employee makes his/her contributions and his/her salary near retirement.

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[1] Derived from the number of annuities in $2000 increments.

The 1990 reforms

6. The taxation of superannuation schemes was changed in 1990 so that contributions and investment earnings became fully taxed and the annuity exempt ('EET' to 'TTE'). Under either regime, the annuity can be described as 'tax paid'.
7. The principle features of the taxation approach finally adopted by the Government were:
    1. tax concessions in relation to contributions made to schemes removed;
    2. investment income taxed at the new top marginal tax rate (33%);
    3. contributions made by employers taxed at the same rate (33%), a deductible expense to employers; and
    4. all benefits payable from such schemes tax free; that is, exempt.
8. Annuities payable from the government employee superannuation schemes (GSF and NPF) were (permanently) reduced from 1 April 1990 by a factor in substitution for the tax payable on annuities before that date. This was done to prevent annuitants receiving a 'windfall gain' from the annuity becoming tax exempt.
9. The Superannuation Schemes Act 1989 (Sections 40 to 45 - now repealed) empowered trustees of defined benefit schemes (in the private sector) to over-ride the normal requirement to secure the agreement of scheme members to adjust (reduce) annuities in concert with the tax changes. While the Superannuation Schemes Act did not apply to the State sector, the Government decided the principles to be applied to private sector schemes would also be applied to the schemes for which the Government was responsible as the employer - the GSF and NPF - so that annuitants would not receive a 'windfall gain' from the annuity becoming tax free[2]. Annuities in comparable private sector schemes were commonly reduced by 15%while some were not reduced at all[3]; the reductions to GSF and NPF annuities were among the highest.
10. The Government Actuary was asked to propose reductions to the GSF annuity which would result in a cost of the scheme to the employer (the Government) which was no greater as a result of the tax changes, while being fair to members of the scheme.
11. For **annuities being paid on 31 March 1990**, the Government decided to reduce each annuity by the tax then payable by the individual (the 'G tax code'), an average reduction of 19%.
    The 1990 tax rates were: 15% (up to $9,500), 28% (to $30,875) and 33% (above $30,875).
    (The 2011 tax rates are 10.5% (up to $14,000), 17.5% (to $48,000), 30% (to $70,000) and 33% (above $70,000).
12. For **future annuities**, the Actuary devised a notional fully funded model for the GSF assuming the top marginal tax rate of 33% for employer contributions and investment earnings, from which a 40% reduction for those retiring from 1 October 1999 was calculated. As the GSF scheme was not fully funded - that is, comprising mostly employee contributions only - the Government decided the appropriate reduction was 30%. The National Provident Fund reduced its annuities by 40%.
13. The final decisions on the reduction factors were rushed to meet the 1 April 1990 implementation date and little thought was given to the effect of future tax changes. Accordingly, as we have been advised by Peter Dunne MP[4], there was an expectation among members of the select committee considering the GSF Amendment Bill in 1990 that the reduction factor for future annuities would subsequently be reviewed. Such a review would have been seen as necessary to satisfy the Government's guiding principle that changes to the scheme were fair to members of the scheme.

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[2] From a Government policy statement.
[3] As reported by the Government Actuary.
[4] Peter Dunne was a member of the Commerce Select Committee that considered the GSF Amendment Bill in 1990

14. While the Superannuation Schemes Act permitted private sector schemes to review their reduction factors, this was omitted from the legislation affecting government annuitants. The cumulative effect of tax reductions applied since 1996 has been seriously to undermine the value of GSF and NPF annuities.
15. One of the effects of the tax reductions has been to give the Fund (and the employer) a 'windfall gain' from the reduced tax on the assumed employer contributions and investment earnings of the fund. A rate of 33% was assumed to apply to everyone in 1990 when the reduction factor was calculated, while the employee's tax rate now applies, with a maximum of 28% on investment earnings. This will have worked to the benefit of the balances of the Government Superannuation Fund and the National Provident Fund since the assumption was that tax rates would not change.
16. A recent actuarial review [5]of the 1990-calculated reduction factor concludes that the reduction would be lowered from 30% to 25% if a tax rate of say 28% was used instead of the 33% assumed in the 1990 calculation as a proxy for the top personal tax rate.

Restoring equity

17. A practicable remedy would be to lower the annuity reduction factors by 15%. This corresponds to the 15% lowering of the tax rate on investment earnings from the 33% rate (used as proxy for calculating the reduction factor in 1990) to 28%. This would be simple to apply and fair to all annuitants.
18. A tax rate of 33% used as a proxy in 1990 for personal tax rates is greatly in excess of current rates. Also, the single 33% rate on contributions to defined contribution superannuation schemes and their investment earnings has now been replaced by the individual saver's tax rates. The taxing of superannuation schemes at a flat rate of 33% was recognised even in 1990 as excessive and action was finally taken in 2004 with the employer superannuation contributions tax (ESCT - formerly the superannuation schemes contributions withholding tax SSCWT) was changed to allow the individual employee's rate to be used and, in 2007, the tax on portfolio investment entities (PIEs) was changed to the employee's rate, with a maximum rate in 2011 of 28%.
19. The GSA has asked the Government to assess the effect on GSF and NPF annuities of a recalculation of the annuity *reduction factor* using taxation applicable in 2011[6].
20. The reduction factor was decided in haste 21 years ago, to be applied (in full) from 12 years ago. These are short periods in a person's lifetime contract with his/her employer. For the Government on behalf of its employer agents to act in 'good faith' in terms of the Employment Relations Act 2000[7] requires an examination of the effect on future annuities of tax cuts not anticipated in 1990 and the devising of a remedy for the unforeseen inequitable effects of decisions made in 1990.
21. As for everyone with long-term saving contracts, Government employees expect the contract with their employer to be honoured. The implications of the decisions made in 1990 changes were not fully known or considered and annuitants expect their employer finally to correct this inequity in their retirement savings contract. This is an employment issue and a matter for the Government as the employer to give effect to the principle asserted by the Government in 1990 that changes to the GSF scheme were to be 'fair to members of the scheme'.
22. **The Association urges the committee to recommend to the House of Representatives that the Government give most favourable consideration to this petition.**

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[5] In 2011, by former Government Actuary Geoff Rashbrooke
[6] Letter to the Prime Minister dated 31 March 2011
[7] Government employers are bound by the Employment Relations Act