

Changes to employer contribution superannuation tax laws – 1 April 2004

Since 1990, New Zealand has operated a “neutral” tax regime in respect of superannuation; contributions are paid out of after-tax income, or are taxed at time of payment, investment income is taxed within the scheme and benefits are paid tax free. Details are set out on page 3.

The tax that applies to employer contributions to a registered superannuation scheme is known as SSCWT. SSCWT was designed to remove any tax differences, on average, for compensation that is delivered indirectly via superannuation when compared with direct, taxable pay. This tax was generally neutral, but not neutral for all employees.

From 1 April 2004, the SSCWT tax rules change (see shaded box). These apply to both defined benefit and defined contribution schemes. The changes should encourage compensation to be delivered as an employer contribution to a registered superannuation scheme.

With the changes to SSCWT, the overall superannuation tax regime will still not be “neutral” - 39% taxpayers retain an advantage and 21% taxpayers will still incur 33% tax on the scheme’s investment income. However, the changes mean that the regime is more “neutral” than it was and the new SSCWT regime is fairer, and has some clear advantages.

Some issues and observations

The intention of the amendment is to reduce the “over-taxation” of an employer’s contribution for members whose marginal

tax rate is less than 33%. This is similar to the multi-rate FBT regime for other fringe benefits. However, the multi-rate SSCWT regime differs from its equivalent FBT regime (where the value of the benefit is added to pay in order to calculate FBT). Multi-rate SSCWT will therefore be much easier to administer than its FBT equivalent.

There are however, some practical issues that potentially arise.

“Last dollar” basis

The appropriate SSCWT rate depends on the employee’s last dollar of taxable pay received from the employer making the contribution (not all employers). The last dollar of pay includes base pay, overtime and bonuses etc.. The amount of the employer’s contribution is not added to pay to set the SSCWT rate.

New employees

For employees who have been employed for more than a year at 1 April, the SSCWT rate for the next year is based on the last dollar of income paid by that employer in the previous year.

For new employees i.e. those with less than a complete financial year’s service, the last dollar of income is the expected last dollar, in the current financial year that will be paid by that employer.

Per employee decision

The legislation implies that the employer can choose to adopt the multi-rate SSCWT regime on an employee-by-employee or

SSCWT From 1 April 2004

The current SSCWT rate on employer contributions is 33% regardless of an employee’s income level or marginal tax rate. From 1 April 2004, the SSCWT regime changes so that, at the employer’s option, the rate of SSCWT can reflect the employee’s marginal rate of tax on direct pay. The employer can continue with the present 33%, or can opt for a multi-rate approach that depends on the tax rate that applies to the employee’s last dollar of taxable pay, but with a maximum of 33%. This is an employer decision.

The multi-rate SSCWT rates are:

On last dollar of taxable pay	SSCWT rate
To \$9,500	15%
\$9,501 - \$38,000	21%
\$38,001 - \$60,000	33%
\$60,001 or more	33%

(maximum applies)

“Taxable pay” for an existing employee is based on the amount paid by the employer in the last full financial year. For a new employee, it is based on an estimate of the current financial year’s pay.

The employee contribution, investment income and benefit payment regimes stay unchanged.

a scheme-by-scheme basis. Employers will therefore need to develop a policy for when

and if it will adopt the new regime.

Payroll functionality

- **variable SSCWT rates**
In many cases, the current payroll systems of an employer may not be able to cope with multiple SSCWT rates. Where this is the case, employers have three key options:
 - (a) Ignore the new SSCWT regime and apply 33% for all employees.
 - (b) Modify the current payroll software to allow for the variable SSCWT rates.
 - (c) Implement a “work-around”. For example, where Aventine is the administrator, Aventine will be able to manage the SSCWT liability and advise the employer of the correct amounts of SSCWT to pay under the variable rate regime.

- **Two definitions of “pay”**
Where any “salary sacrifice” operates, the employer will need to keep two definitions of “pay” for members. The first records taxable pay i.e. subject to the PAYE system. The second records base pay before salary sacrifice to preserve parities between members and non-members. Some payroll systems cannot cope with two definitions of “pay”.

Minimum rate of pay and collective agreements

There may be compliance issues with minimum pay and collective agreements. This may also give rise to equity issues. In determining its policy on the new SSCWT regime, an employer will need to address each of these issues.

“Salary sacrifice”

- **concession remains for top earners**
There is presently a concession for 39% taxpayers (earning more than \$60,000 a year) and who save by using “salary sacrifice”¹. That concession remains because the maximum multi-rate SSCWT is 33%.
- **but now has wider application**
Where an employee’s taxable pay is a little over one of the tax bands (\$9,500 or \$38,000), then “salary sacrifice” has potentially a wider application than now. Salary sacrifice can result in a lower SSCWT rate being applied and therefore more of the employer’s contribution is saved for an employee’s retirement.

To illustrate this, take an employee who is on, say, \$39,000 a year and who belongs to an employer-subsidised scheme where the employee pays 5% (\$1,950) and the

employer matches that. After-tax the employee has \$29,310 a year and has total net superannuation savings of \$3,256 a year.

The alternative is for the employee to “sacrifice” \$2,620 of pay (this is the gross amount of income the employee earns to pay his current \$1,950 contribution) and for the employer to increase its contribution by the same amount. Under the alternative, the employee’s take home pay is the same but the net superannuation savings increases to \$3,610; a gain of \$354.

The table below shows the present and alternative calculations.

In the example the member’s current contribution is simply moved on to a “salary sacrifice” basis leaving everything else the same. The \$1,950 is equivalent to \$2,620 gross which lowers the member’s taxable pay by this amount to \$36,380. It therefore lowers the marginal tax rate on the last dollar of pay to 21% and

	Present	Alternative - from 1 April 2004
	\$	\$
Pay		
Gross income	39,000	36,380
PAYE tax	<u>7,740</u>	<u>7,070</u>
Net income	31,260	29,310
Employee contribution	<u>1,950</u>	<u>0</u>
Take-home pay	29,310	29,310
Superannuation		
Employer contribution	1,950	4,570
Less SSCWT	<u>644</u>	<u>960</u>
Net employer contribution	1,306	3,610
Member contribution	<u>1,950</u>	<u>Nil</u>
Total net superannuation	3,256	3,610
Summary		
Net position		
- net take-home pay	29,310	29,310
- net superannuation	<u>3,256</u>	<u>3,610</u>
- total net remuneration	32,566	32,920
Gross position		
Total cost to the employer	40,950	40,950

so improves the net superannuation position for the employee in two ways:

- the SSCWT rate will be 21% in the example rather than the 33% that would apply if the employee's taxable pay were more than \$38,000. The 21% applies to the full employer contribution. That improves the net value of the employer's existing contribution by \$234.
- the member's own contributions are also, effectively, subject to 21% tax whereas at present they are paid from after-tax income (taxed at a mix of 21% and 33%). This improves the position for the member by \$120.

Overall, the member's superannuation position is improved by \$354 a year at no cost to the employer, other than some administration, and without altering the employee's net take-home pay.

Increasing an employee's retirement savings and security must ultimately benefit the employer in its employee management policies.

No more member contributions?

Under the new SSCWT regime, all member contributions should probably be handled on a "salary sacrifice" basis rather than from after-tax pay, as is now usual. Although only members just over the tax steps will see the improvement shown in the example, changing all member contributions will eliminate the administrative inconvenience of dealing with affected members individually as they come into the "zone".

Employers should therefore review their benefit design and remuneration philosophy. If a change is made to handle employee contributions by way

of salary sacrifice, employers may also need to review their remuneration communication policy, to ensure that employees understand their total remuneration.

Voluntary "sacrifice"?

Even if the employer did not want to change all member contributions to "salary sacrifice" but was willing to let a member sacrifice pay on a voluntary basis, the employee may still benefit. For example, in our earlier example, an additional, voluntary contribution of \$1,001 a year would save tax by bringing the employer's contractual (and "salary sacrifice" contributions) into the 21% tax band. That way, members who are saving for their retirement, can improve the after-tax value of both their own voluntary savings and the employer's contributions. If our example employee were already saving the \$1,001 elsewhere (from their after-tax pay), shifting that to an employer scheme on a salary sacrifice basis (all else staying the same) will also improve the member's net position by a total of \$354 a year.

Employer benefits?

If the employer's contribution to a scheme is expressed as a net amount, the employer will benefit from the change to stepped SSCWT. The gross contribution needed to provide the net amount will be less for employees whose pay is less than \$38,000 a year.

1. "Salary sacrifice" is where an employee sacrifices (gives up) part of his/her salary and in return receives an equivalent employer contribution. For more information refer to the Aventine article: "Salary Sacrifice - a general discussion."

Superannuation tax regime

The current tax regime that applies to registered superannuation schemes in New Zealand is shown below. The tax regime that applies to unregistered schemes, remains the FBT regime.

Employee contributions

Contributions paid by employees are paid out of their after-tax income. Such contributions are therefore taxed at the employee's marginal tax rate of 15%, 21%, 33% or 39% (or a mix as the employee crosses a band).

Employer contributions

In contrast to an employee's contributions, where an employer contributes to a "registered superannuation scheme", it must pay a "specified superannuation contribution withholding tax" (SSCWT). The current rate (prior to 1 April 2004) is 33% of the before-tax contribution. The 33% applies regardless of the level of the contribution and regardless of the employee's marginal income tax rate. The employer pays the IRD the tax and pays the scheme the net contribution. An example shows how this works:

Employer contribution	\$100	
SSCWT (standard rate)	<u>\$33</u>	(to IRD)
Net contribution	\$67	(to scheme)

SSCWT is "neutral" for employees with a 33% marginal tax rate, but over-taxes employees with either a 15% or 21% marginal rate and under-taxes employees with a 39% marginal rate.

Details of the new SSCWT rates are shown on page 1.

Benefit payments

Benefits payable from a scheme are paid tax free. However, if a member on a marginal tax rate of 39% withdraws a benefit funded by employer contributions, a withdrawal tax of 5% of the benefit attributable to the employer's contributions can be payable as "fund withdrawal tax" (FWT). FWT was intended to limit tax avoidance for 39% taxpayers who are under-taxed in respect of the employer's contributions under the SSCWT regime. There is a list of exceptions to the application of FWT that, generally, can exempt most benefits paid on leaving service.

Investment income

Investment income is taxed within the scheme at 33% and raises no tax liability in the hands of the member.