

**INVESTMENT SAVINGS & INSURANCE ASSOCIATION OF  
NZ INC**

**Submission  
to the  
Finance and Expenditure Committee  
on the  
Taxation (Annual Rates, Returns  
Filing and Remedial Matters) Bill**

8 February 2012



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## Taxation (Annual Rates, Returns Filing and Remedial Matters) Bill

### Background

1. The Taxation (Annual Rates, Returns Filing and Remedial Matters) Bill (“the Bill”) had its first reading in Parliament in September 2011.
2. Clauses 75 – 81, 103, 112, 113 and 130 of the Bill propose to amend the employer superannuation contribution tax (“ESCT”) rules to:

*“codify the long-established practice of deducting employer superannuation contribution tax (ESCT) from superannuation contributions made on behalf of past employees.”*

3. Further, the Bill:

*“provides that a 33% rate of ESCT applies to [the above-mentioned] contributions”.*

### Submission

4. This submission proposes that, as opposed to only a flat ESCT rate of 33% applying to contributions made on behalf of past employees, the employer should have the option of applying either:
  - a flat 33% rate of ESCT, or
  - progressive ESCT rates, where sufficient information is available.
5. This submission is limited to contributions made on behalf of past employees and does not consider the ESCT implications for contributions made in relation to existing employees.

Employer contributions for past employees arise in defined benefit schemes and in most cases the past employee has retired and is receiving a pension from the scheme. Certain defined benefit schemes permit a past employee to remain a member although they are employed by another (non-associated) employer. However, employer contributions that are the subject of this proposed amendment are mainly in relation to pensioners who are likely to be on a lower effective marginal tax rate.

### Commentary

6. First, we support:
  - The codification of the practice of applying ESCT to superannuation contributions made on behalf of past employees, and
  - The clarification of the definition of employer’s superannuation cash contribution to include such contributions.

7. However, we do not agree that the only option should be for the employer to apply a flat 33% rate of ESCT to superannuation contributions made on behalf of past employees.
8. In practice, employers often apply the progressive rates of ESCT in clause 1 of Part D of Schedule 1 of the Income Tax Act 2007 to contributions made on behalf of past employees.
9. The proposed legislation does change current practice in this area.
10. We consider it appropriate that the deduction of ESCT from contributions made on behalf of past employees be codified. However, we consider that the practice of being able to use the progressive ESCT rates should also be codified and that a flat rate of 33% is inappropriate.
11. To recognize compliance costs and some industry practice, the application of the progressive ESCT rates should be an option, as opposed to it being a requirement.
12. Specifically, we consider that a flat 33% rate of ESCT should be the default rate for contributions made on behalf of past employees. However, there should remain an option to apply the progressive ESCT rates, subject to the employer having sufficient information to do so.
13. Some employers may choose to apply a flat 33% ESCT rate because of the compliance costs that can be associated with using the progressive ESCT rates. However, this should not be grounds for not having the option to apply the progressive rates of ESCT.
14. Having the option to apply the progressive ESCT rates is consistent with the commentary on the Taxation (Annual Rates, GST, Trans-Tasman Imputation and Miscellaneous Provisions) Bill, which from 1 April 2004 introduced the progressive rates of ESCT (previously called Specified Superannuation Contributions Withholding Tax ("SSCWT")), which noted that (emphasis added):

*"Some have raised concerns about imposing further compliance costs on employers ... For this reason, the legislation will make aligning the rate of tax on employer contributions with the employee's marginal tax rate permissive rather than mandatory."*
15. Our view is that the intention, when the progressive rates of SSCWT / ESCT were introduced, effective from 1 April 2004, was for those progressive ESCT rates to be available in relation to all employer contributions, not only those contributions made on behalf of existing employees.
16. Dr Michael Cullen (Minister of Finance, Minister of Revenue) noted at the time that the flat 33% rate of ESCT that existed prior to 1 April 2004 resulted in (emphasis added):

*"the over-taxation of employees earning below \$38,000 per annum, as their marginal income tax rates are much lower than that. This is an inequitable outcome and may discourage them from participating in employment-based superannuation schemes. Therefore, we will soon be introducing legislation to deal with that concern."*
17. Further, commentary to the Taxation (Annual Rates, GST, Trans-Tasman Imputation and Miscellaneous Provisions) Bill noted that the progressive ESCT rates were to (emphasis added):

*“... allow for the appropriate taxation of employer contributions to employer-based superannuation funds for employees earning \$38,000 or less.”*

And that:

*“The measure is intended to reduce the over-taxation of the retirement savings of low-income people.”*

18. Therefore, having the option to apply the progressive ESCT rates to contributions made on behalf of past employees will go towards ensuring there is not over-taxation.
19. We consider there will be two categories into which past employees can be divided, being those that are:
  - a. Still working (but who are with a different employer), and
  - b. No longer working and are pensioners.
20. We propose that both categories be treated in the same manner.
21. As noted above, we recommend that the employer should have the option of applying progressive rates of ESCT. The information necessary to be able to apply those rates should be collected through seeking confirmation of the past employee's appropriate ESCT rate.
22. From a practical perspective, we recommend that this could be done in a way similar to how a portfolio investment entity (“PIE”) is currently required to ask an investor to provide their prescribed investor rate (“PIR”) at least once a year.
23. In most circumstances, a superannuation fund will correspond at least annually with its members. Therefore, we do not consider that seeking and processing ESCT rates from past employees will impose significant additional compliance costs. However, given the proposed optional application of the progressive ESCT rates for contributions made on behalf of past employees, this is an employer decision.
24. Where an employer does seek confirmation from the relevant member, most likely through the superannuation fund, of that member's ESCT rate, the employer should be able to rely on the notification provided by the past employee.
25. Consistent with the other ESCT changes in the Bill, we consider the legislation codifying an employer's ability to choose to apply progressive ESCT rates to contributions made on behalf of past employees should also have a 1 April 2008 application date.

END