pensioncommentary

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An article from the Retirement Policy and Research Centre

Employers should take charge, or KiwiSaver will increase their costs

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From 1 April 2008, employers must start contributing to KiwiSaver for all employees who join (from ages 18 to 64). The contributions start at 1% and grow by 1% a year until they reach 4% from 1 April 2011. Employees must pay 4%.

There is an alternative contribution regime that starts at 2% employees/2% employer from 1 April 2008, increases to 3%/3% from 2010 and 4%/4% from 2011.

Unless employers and employees agree, the employer's contributions must be paid on top of other pay, even (in many cases) if there is an existing subsidised superannuation scheme that an employee belongs to. That scheme can, if it meets some minimum conditions, let the employer off the hook, but not otherwise and then only for scheme members themselves.

On the face, this means higher costs for employers. The "employer tax credit" of up to $1,043 will reduce those costs but, from 1 April 2009, employers' costs will exceed the government's subsidy for most KiwiSaver employees.

But that need not happen and here's why.

If the employer agrees with employees that the compulsory KiwiSaver contributions are part of the employee's overall remuneration, an employee who joins KiwiSaver will see a reduction of $1 in direct taxable pay for every $1 of the employer's compulsory contribution. That means no increase in the employer's costs of employment. The agreement must be made after 13 December 2007 (the KiwiSaver Act outlaws earlier agreements) and should ideally be made before the compulsory contributions start on 1 April – though not necessarily.

Why might an employer do that? The obvious answer is to control KiwiSaver costs after 1 April 2009 but that's not the best reason.

In principle, it seems unfair for an employer to pay more total remuneration to an employee who joins KiwiSaver than to other employees just because the employee chooses to join KiwiSaver. If two employees are doing exactly the same job, with the same experience and qualifications, they should in principle be paid the same. On equity grounds, therefore, the employer should want to reach agreement with employees that a decision to join KiwiSaver will not affect the total amount the employer pays to get a job done.

The required agreement is simply achieved.

Let's say the employer proposes to increase all employees' pay by 4% from 1 April 2008. The employer will say that the increase will be called the "Superannuation Component" of employees' overall pay. All employees will then have a choice about how to receive the Superannuation Component. All or some of it can be:

(a) contributed as the employer's contribution to KiwiSaver, by joining KiwiSaver;

(b) contributed as the employer's contribution to another superannuation scheme;

(c) paid as taxable income.

The agreement will comprise the employer's offer and the employees' decisions to take the pay rise and to make their choices as to where they want the Superannuation Component paid. They can change that decision from time to time.

In case (a), the employer's obligation to make KiwiSaver contributions is also satisfied. In either cases (b) or (c), if the employee decides to join KiwiSaver later, the Superannuation Component will be re-adjusted accordingly. The separate treatment of the Superannuation Component must be maintained as the employee can always change that decision. The regular pay slip should be noted accordingly from now on.

The example is kept simple with a single pay rise of 4% from 1 April 2008 - the same can be achieved with several increases over a period of years (even with different increases for different groups) as long as the increasing Superannuation Component continues to be separately identified. The Superannuation Component increases could stop when the 4% level is reached but the employer could extend the principle to other benefits, like life or medical insurance.

Even if the employer were proposing to increase pay later in 2008, there is a case to bring at least 1% of that increase in from 1 April when the KiwiSaver obligation begins. It's tidier that way.

It might seem that the Superannuation Component defeats the government's apparent aim to force employers to contribute to KiwiSaver (by increasing total remuneration). From a narrow perspective, it may look that way but equity should be an important issue for employers. Equity means paying people to get a job done based on the work they do rather than on whether they need to save for retirement or, indeed, whether they can afford to save.

Employees will still want to join KiwiSaver; nearly everyone should do so – the tax breaks are too generous to ignore. Employers can, if they wish, have a role to explain that. If employees decide to join, the Superannuation Component will be tax-free to the employee; there is the tax-free 'kick start' and the tax-free annual 'member tax credit' of $1,043 (as long as the employee contributes at least that much). The investment income in KiwiSaver is also taxed on a favourable basis.

And here's another thing – if employers use the Superannuation Component and so are financially indifferent whether employees join KiwiSaver, employers should pass on to

KiwiSaver members the 'employer tax credit' they receive from taxpayers of another $1,043 a year. That will be taxable income to employees (and will change the required KiwiSaver contributions). It's a free pay rise for KiwiSaver members at the taxpayers' expense and can help subsidise the employee's own 4% contributions. So employees should be happy as well and more will join KiwiSaver as a result.

But employers should take charge of the KiwiSaver contribution issue otherwise their costs will increase. Moving before 1 April is ideal though they can make the decision later.