

Taxation, decumulation and annuities - a brief backgrounder

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Four main points

- Shift to TTE has removed annuity market's life support system
- Government has created a complex 'proxy' tax system for collective investment vehicles (CIVs) to achieve TTE
- TTE requires a more advice-driven approach to decumulation
- Tax may be headline impediment for annuities, but other issues more significant

TTE and the annuity market

- TTE means the state has no tax reason to regulate benefits
- Pensions/annuities/other benefits under EET need intricate controls
- The last New Zealand provider sold its final annuity in 2013
- Move away from annuities a global trend

Complex 'proxy' regime for CIVs

- CIVs still an essential part of retirement saving and decumulation
- Most KiwiSaver schemes are PIEs; also many other CIVs
- CIVs tend to calculate and pay tax as proxy for investor's liability
- Proxy regimes are complex and riddled with inconsistencies

TTE and decumulation

- Retirees still need to reliably run down their financial savings
- Risks range from running out to unintended bequests
- Traditional annuities not presently an option
- Possibilities include 'managed draw-downs'

Impact of tax

- Annuities:
 - Provider's income taxed at 28%
 - Not taxed as proxy for annuitant
 - Tax-paid
 - Not 'income' for PIR rates
 - 'Income' for welfare benefits
- PIE CIVs:
 - CIV's income taxed at investor's PIR rate
 - PIE taxed as proxy for investor
 - 'Income' for PIR rates
 - 'Income' for welfare benefits

Annuities – at alternative tax rates

(purchase price \$100,000 at age 65)

5% p.a. gross return and tax at:

0% 10.5% 17.5% 28% 33%

Male

	0%	10.5%	17.5%	28%	33%
Annuity (p.a.)	\$8,616	\$8,243	\$7,998	\$7,634	\$7,462
Annual concession	\$1,154	\$781	\$536	\$172	Nil
Present value	\$15,464	\$10,465	\$7,182	\$2,305	Nil

Note: 'Annual concession' is the annual difference from the annuity calculated at 33%

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Female

Annuity (p.a.)	\$7,964	\$7,594	\$7,350	\$6,989	\$6,819
Annual concession	\$1,145	\$775	\$531	\$170	Nil
Present value	\$16,786	\$11,361	\$7,784	\$2,492	Nil

Unisex

Annuity (p.a.)	\$8,275	\$7,905	\$7,657	\$7,294	\$7,128
Annual concession	\$1,147	\$777	\$529	\$166	Nil
Present value	\$16,092	\$10,903	\$7,422	\$2,329	Nil

Note: 'Annual concession' is the annual difference from the annuity calculated at 33%

Comments on annuity examples

- Tax important but not significant hurdle
- Male/female distinction important but not significant
- Adverse selection probably more material
- Other issues more significant:
 - Institutional risk
 - Loss of flexibility
 - Bequest motive
 - Distribution costs
 - Relatively poor value for money