

## KiwiSaver, employer contributions and remuneration

RPRC *PensionBriefing* 2013-5

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**This *PensionBriefing* reminds readers that the employer's compulsory KiwiSaver contribution of, now, 3% of pay is not necessarily an addition to the employee's 'total remuneration'.**

### In summary

From 1 April 2013, the minimum KiwiSaver contributions increased to 3% from both members and their employers. That saw many employees' 'total remuneration' increase by the employer's additional 1%. Take-home pay was, however, lower because the employee's extra 1% comes out of their after-tax pay.

In other cases, 'total remuneration' was unchanged from 1 April so that, unless there was also a pay increase, the employee's take-home pay reduced by the 2% (the total of the employer's and employee's contributions<sup>1</sup>).

### Background

When KiwiSaver started on 1 July 2007, there was considerable confusion about the newly introduced compulsory employer contributions. The government added that requirement without a full debate and was probably surprised that it could not force some employers to pay the employer's contributions on top of their ordinary pay. Where employers used a 'total remuneration' approach, the employers' contributions were part of pay.<sup>2</sup>

*PensionBriefing* 2008-3 *KiwiSaver, compulsory employer contributions and remuneration* described two attempts by the previous government to set the rules on this.

- The first, passed on 13 December 2007, said that the employer could agree with employees that the employer's contributions from 1 April 2008 would form part of 'total remuneration'.
- The government then had another go in legislation passed on 2 September 2008 that essentially outlawed the 'total remuneration' approach. In summary, a personal grievance was established if a KiwiSaver employee's 'salary or wages' were less than those of a non-KiwiSaver employee because the employer had taken the compulsory employer contributions into account in setting the KiwiSaver member's 'salary or wages'.

The 2008 *PensionBriefing* is accessible [here](#).

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<sup>1</sup> The member's 1% comes from after-tax pay; the employer's contribution comes from the employee's gross pay so the actual reduction in take-home pay will be after ESCT at the employee's top marginal rate.

<sup>2</sup> The RPRC thanks the Employers and Manufacturers Association for the use of information on the incidence in 2013 of 'total remuneration' (see page 3).

The position changed again with the new National-led government. The Taxation (Urgent Measures and Annual Rates) Act 2008 removed the 2 September 2008 provision and allowed parties to agree that the employer's contributions could be part of 'total remuneration'. What is now section 101B(4) of the KiwiSaver Act 2006 essentially restored the position that applied from 13 December 2007.

### The present law

The default position (section 101B(1)) says that "...compulsory contributions are paid in addition to an employee's gross salary or wages..."

However, section 101B(4) says that the employer and employees "are free to agree contractual terms and conditions that disregard [section 101B(1)]". There are some conditions to this:

- the agreement must be made after 13 December 2007;
- existing contribution arrangements or agreements are not affected.

To remind everyone of an obvious point that applies to all employment-related agreements, section 101B(5) states that the parties must, as required by section 4 of the Employment Relations Act 2000 "deal with each other in good faith".

### Two different remuneration practices

The law seems clear: if the employer and employees agree, the employer's contributions can be either added to other pay or included in 'total remuneration'. If there is no specific agreement, they must be added to pay.

There are two main ways to think about the treatment of an employer's contributions to a workplace superannuation scheme, including KiwiSaver:

- **'Pay + benefits'**: Employees receive taxable pay<sup>3</sup> and, if they join the subsidised superannuation scheme, the employer also contributes. Employees who join therefore get more in total remuneration than those who do not. Employees who do not join are not compensated for their 'loss'.
- **'Total remuneration'**: The employer sets a total 'price' for the job. If the employee joins the subsidised superannuation scheme, total remuneration stays the same but the amount of regular take-home pay reduces. Both members and non-members, who are otherwise equivalent employees, will receive the same total remuneration.

Before KiwiSaver, most employees in New Zealand were paid under the 'total remuneration' approach because most employees received no subsidised employee benefits, including superannuation.

Since 2007, most KiwiSaver members collect the employer's contributions on top of taxable pay and so have effectively shifted to a 'pay + benefits' approach. This means

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<sup>3</sup> For consistency in this *Pension Briefing*, 'pay' is the regular amount an employee receives each week or month and excludes indirect benefits such as superannuation, the value of medical insurance or motor vehicle etc. Pay is subject to tax under the PAYE regime. The KiwiSaver Act calls this "salary or wages". 'Total remuneration' refers to the combined value of all the direct cash and indirect benefits an employee receives from the employer. Indirect benefits are, in most cases, subject to either FBT or Employer Superannuation Contribution Tax (ESCT).

that KiwiSaver members are paid more in total by their employer than their non-KiwiSaver colleagues who do the same job and are paid the same taxable pay<sup>4</sup>.

### Limited survey data

There is limited information on employers' overall remuneration approaches. The Employers and Manufacturers Association (EMA) advises us that its *National Employers Wage & Salary Survey* for April 2013 showed the following:

- Across all measured positions in the survey, between 26% to 28% of employees are paid under a formal 'total remuneration' policy.
- The dominant employer contribution rate across all measured positions was 2%-2.99% (between 72-80% of employers by job levels). In other words, employers were mostly paying the minimum required KiwiSaver contribution.

As far as we know, there are no other national statistics on this. We think that the Inland Revenue's regular KiwiSaver evaluation reports should investigate this issue.

### The impact of the minimum wage

A recent decision of the Employment Court<sup>5</sup> has modified the total remuneration approach in respect of employees who are on the minimum wage.

The employer argued that its 'total remuneration' approach met the minimum wage obligation despite the fact that the KiwiSaver component was paid to a scheme for the employee's retirement.

The full court held that the "underlying purpose of the [Minimum Wage Act] is to ensure that workers receive a living wage, to meet basic day-to-day living expenses..." so deducting employer's contributions from that minimum frustrated the Act's intentions.

There are several unsatisfactory aspects to the court's decision:

- There was no discussion on the implications of the employee's choosing to join and to receive less than the minimum wage by virtue of just the member's contributions. The employee could be said to have forgone the right to have at least the minimum amount to "meet basic day-to-day expenses". If the court had been consistent, the employer should have paid at least the minimum wage, regardless of even the member's contributions.
- There was also no discussion on the situation where the employees were receiving more than the minimum wage but not enough to meet the employer's contributions under a total remuneration approach. Presumably the employer could take at least some of the employer's contributions as long as what was left was at least equal to the minimum wage.
- The judgment misunderstood the true nature of KiwiSaver by mis-characterising some aspects of its design:

"[21] There is no guarantee of receipt of the benefit of the employer contribution (or indeed of the employee's own contribution) by the employee under the Scheme<sup>6</sup>. The monetary value of the contribution may never be realised at all or

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<sup>4</sup> A KiwiSaver member also receives the initial \$1,000 kick-start and as much as \$520 a year in the so-called 'member tax credit'.

<sup>5</sup> Faitala and Goff v. Terranova Homes & Care Limited (2012) – the full decision is accessible [here](#).

<sup>6</sup> The court referred to section 205 of the KiwiSaver Act 2006 in support. This states: "There is no Crown guarantee in respect of any KiwiSaver scheme or investment product of a KiwiSaver

in full. Nor is the money paid out as salary when it is ultimately received by the employee. Rather it is paid out as a pension.”

None of these statements is correct or even relevant. However, the judgment did not need to rely on these supposed characteristics of KiwiSaver to reach its decision.

### **The implications of remuneration strategies**

The minimum wage issue aside, we might expect employers to pay the same pre-tax remuneration to equivalent employees who are doing the same job. In practice, that does not happen under ‘pay + benefits’ and KiwiSaver illustrates that:

- For employees’ doing the same job, the employer spends more on members than on non-members.
- If the employer’s budget for future pay increases is constrained by the total costs of employment, as will almost always be the case, there will be smaller amounts available for future direct pay increases. That will affect both members and non-members but, because members are receiving the employer’s contributions in full, they will be less affected overall. The reduced future direct pay increases for non-members will, however, be indirectly subsidising the employer’s contributions to KiwiSaver.

Unless all employees belong to KiwiSaver, the employer is effectively paying more in total to members than to non-members. It is then in the employer’s financial interests if employees do not join or, having joined, start a contributions holiday. While there is no evidence that any employers save money by influencing employees considering KiwiSaver membership, the design does allow that possibility. Under ‘total remuneration’ the employer is unaffected financially by the employee’s decision to join and so there are no perverse incentives.

It seems difficult to justify a distinction in total remuneration based solely on an employee’s KiwiSaver membership status. However, some employees cannot afford to join KiwiSaver; others may not see the need to save for retirement in that particular way or may want to defer that decision. On those grounds alone, compelling KiwiSaver membership seems unhelpful, remuneration issues aside.

This analysis is unaffected by the tax subsidies given to KiwiSaver members. They improve the after-tax value of their remuneration but at no direct cost to the employer itself. However, the taxes that everyone pays (employers and employees) are higher in the presence of those subsidies. Again, non-members (and employers) will have higher taxes to pay for the subsidies received by members, who also help pay for them through higher taxes. That makes tax breaks regressive because they subsidise the more highly paid at the expense of all, including the lower paid.

The higher taxes and their inequitable distribution are features of any tax concession. The lower future direct pay rises, on the other hand, are a direct consequence of the compulsory employer contributions in a ‘pay + benefits’ environment.

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scheme.” That is an irrelevant consideration and is no more sensible than saying money in a bank account does not belong to the account holder because the bank’s liabilities are not government-guaranteed. In fact, all of the employer’s contributions (and the member’s) are fully vested in the member from the outset, as are the tax subsidies. It is the vesting, not the absence of a Crown guarantee that matters when assessing the employee’s overall remuneration.

In summary, under ‘pay + benefits’, those who cannot afford to join KiwiSaver (or who choose not to join) will suffer directly and indirectly for the lost opportunity.

## **Conclusion**

The government has intervened in remuneration arrangements between employers and employees. It requires part of an employee’s remuneration to be delivered in a particular way (through KiwiSaver) and at a particular time (retirement).

At least in the short run, the government also attempts to specify what, in total, should be paid. If the employer uses ‘pay + benefits’, for the reasons stated, we should expect the total costs of employment for all employees (including KiwiSaver subsidies) to drift down in real terms to what the employer can actually afford.

Employers can address this by agreeing with employees, in good faith, that the employer’s compulsory contributions are part of ‘total remuneration’.

Then, employees themselves can decide whether part of that total remuneration is deferred until retirement or taken today as taxable pay. Employees seem best placed to make that decision.

Importantly, in this context of KiwiSaver, all employees who do the same job will be paid the same. That also seems a desirable objective.

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