Office of Hon Jo Goodhew

MP for Rangitata
Minister for the Community and Voluntary Sector
Minister for Senior Citizens
Minister of Women's Affairs
Associate Minister of Health
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Peter Pieruschka
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Dear Mr Pieruschka

Thank you for your email of 11 December 2013 to Hon Craig Foss which has been transferred to me for reply as the issues you have raised fall within my portfolio responsibilities.

You have noted in your letter that Hon Craig Foss stated in Parliament regarding the direct deduction policy that "...the rationale for the direct deduction policy is that all New Zealanders receive the equivalent amount of New Zealand Superannuation (NZS)...". You have also noted that several recipients of German state pensions feel that they are disadvantaged because the pre-tax German pension is deducted from NZS but the German pension is fully taxed in Germany.

I do not believe that this situation will disadvantage German pensioners as long as the German and New Zealand tax rates are generally similar.

Here are two simple scenarios. The first looks at a person who receives a German social security pension and is therefore subject to the direct deduction policy and the second looks at a person who simply receives NZS. For simplicity, I have assumed that the gross NZS payment is $250. I have also assumed that both Germany and New Zealand have a flat tax rate of 20 per cent on income. This is to simplify the example because using the actual progressive tax rates for each country would complicate the example but should not change the overall result.

Scenario 1 – German social security pension and NZS subject to the direct deduction policy
Person receives a $100 pre-tax German social security pension, which is subject to 20 per cent German tax. New Zealand is not able to tax this social security pension under the terms of the double tax agreement. As New Zealand does not have the right to tax the $100 pension, it should not be included in the person's New Zealand tax return. After German tax, the person receives $80.

Assuming that the maximum NZS payment is $250 before tax and the person is subject to direct deduction, they will be entitled to receive $150 of NZS before tax ($250 - $100). The $150 is subject to New Zealand tax of 20 per cent. This equates to $30 of tax and they will receive $120 of NZS after tax. Adding up the after-tax amounts of the German social security pension and NZS, the person will have $200 ($80 + $120).

Scenario 2 – person receiving only NZS
This person is entitled to $250 of NZS. They don't receive a social security pension from overseas so nothing needs to be deducted under the direct deduction policy. New Zealand tax of 20 per cent will be applied to the full $250. This equates to $50 of tax, so they will receive $200 of NZS after tax.

Therefore, we can see that the people in the two scenarios are in the same after-tax situation. As mentioned at the beginning, if you were to take into account the different progressive tax rates in Germany and New Zealand, you should end up with a similar result after tax (but it wouldn't be exactly the same). So, the policy of deducting a gross social security pension from a person's gross NZS entitlement gives a fair result.

You have also asked about requests made by the German Government for New Zealand to review the application of direct deduction to German pensions.

The most recent request was in April 2012 when the German Ambassador to New Zealand proposed a social security agreement that would eliminate or modify the direct deduction policy for German pensions. After due consideration, it was not possible to agree to his proposal. In terms of eliminating the direct deduction it was noted that the qualifications for NZS are relatively generous. If a person has 10 years of qualifying New Zealand residence and presence since the age of 20 (five years of which must be after age 50), they are eligible for a full pension payment when they turn 65. Given that full entitlement to NZS can be obtained after a comparatively short period of time, it is possible for a person who has lived in both New Zealand and another country to be entitled to full NZS and a relatively substantial overseas pension.

People who have lived and worked overseas, both returning New Zealanders and migrants to New Zealand, will not have contributed to this country to the same extent as life-long New Zealand residents through the taxes and other levies that are used to fund the NZS scheme. The direct deduction policy ensures that people with an overseas pension (and therefore a reduced amount of NZS) receive an amount equivalent to the rate of NZS that lifelong New Zealanders receive.

The Ambassador also suggested that, as an alternative, New Zealand modifies the direct deduction policy so that German pensions are treated in a similar way as they would be in Australia. The Australian Age Pension has some similarities to NZS. Both schemes require a ten year residence period from the age of 20 before entitlement can be granted, although New Zealand has an additional residence requirement of five years in New Zealand from the age of 50. However, a key difference is that the Australian Age Pension is income and asset tested. This means that German pensions are generally treated as income, which only partially abate the rate of Australian Age Pension, rather than reduce it on a dollar-for-dollar basis. If New Zealand were to adopt this as a way of treating German pensions, it would be a significant departure from the general principle that NZS is not income tested. The Government has made a clear undertaking to the New Zealand public that the main characteristics of NZS will not be changed during its term of office.

While I acknowledge that the German Government may have on going reservations about New Zealand's direct deduction policy, New Zealand could not enter into a social security agreement that would modify or eliminate this policy solely for German pensioners living in New Zealand. However, New Zealand remains open to further discussions should the German Government wish to enter into a social security agreement that would not modify the direct deduction policy.

Thank you for writing.

Yours sincerely

Hon Jo Goodhew
Minister for Senior Citizens