

Special report from the
Policy Advice Division of Inland Revenue

The new KiwiSaver legislation

This report will form the basis of an article to appear in the Tax Information Bulletin.

The legislation giving effect to compulsory employer contributions and the employer tax credit is contained in the Taxation (KiwiSaver) Act 2007, which received Royal assent on 19 December 2007, and will apply from 1 April 2008. The new Act also includes a number of other amendments. The most significant, discussed in this special report, are changes to the member tax credit, the establishment of a process to deal with invalid KiwiSaver enrolments, changes to the definition of “salary and wages”, changes to complying fund rules, and regulatory regime changes.

BACKGROUND

The government announced in Budget 2007 a number of changes to KiwiSaver that significantly increase the incentives to join and to continue making regular contributions. The key changes are:

- A tax credit to members that matches their contributions to a KiwiSaver scheme, or a complying superannuation fund, up to a maximum of \$20 per week. The legislation giving effect to the member tax credit was enacted in May, in the Taxation (KiwiSaver and Company Tax Rate Amendments) Act 2007, and applies to contributions made from 1 July 2007.
- A compulsory employer contribution when an employee contributes to a KiwiSaver scheme or a complying superannuation fund that will be phased in over four years, starting at 1 percent from 1 April 2008, reaching 4 percent of gross salary or wages from 1 April 2011. This has been legislated for in the Taxation (KiwiSaver) Act 2007.
- An employer tax credit which will reimburse employers for contributions they will be required to make into their employees’ KiwiSaver scheme or complying superannuation fund up to a maximum of \$20 a week for each employee. This has also been legislated for in the Taxation (KiwiSaver) Act 2007.

KEY FEATURES

The new rules for KiwiSaver and complying funds involve changes to the KiwiSaver Act 2006, Income Tax Act 2004, Tax Administration Act 1994, Superannuation Schemes Act 1989 and the KiwiSaver Regulations 2006. The main changes are:

- New rules for the member tax credit, the main changes being:
 1. The period of membership for the purposes of calculating the member tax credit is clarified, and a definition of “creditable membership” is introduced.
 2. Contributions received by the Commissioner but not transferred to a provider in the member credit year will count towards the calculation of the credit, and a definition for “member credit contributions” is introduced.
 3. The formula for calculating the amount of credit is simplified.
- Rules to establish compulsory employer contributions.
- Rules to establish the employer tax credit.
- Rules for dealing with “invalid KiwiSaver enrolments”.
- Amendments to the definition of “salary or wages”.
- New rules for minimum employee contributions.
- A number of changes have been made to the regulatory regime:
 1. The definition of “independent trustee” is amended to remove the requirement that the trustee be independent from the administration and investment managers of the scheme.
 2. An amendment has been made to section 206 of the KiwiSaver Act to provide that persons are not investment brokers if they merely exercise a function, duty or power under the KiwiSaver Act.
 3. A new section has been introduced to require all KiwiSaver schemes and complying superannuation funds to disclose their approach to responsible investment.
 4. A new section provides transitional relief for KiwiSaver and complying superannuation fund providers for any non-compliance with any Act until 31 January 2007.
- A number of changes have been made with respect to complying superannuation funds:
 1. The definition of complying fund rules has been amended.
 2. Compulsory employer contributions to complying superannuation funds must be allocated to the investment profile chosen by members and be fully vested.
 3. The Superannuation Schemes Act 1989 has been amended to enable schemes that provide insurance benefits that are linked to superannuation accumulation to reduce those insurance benefits if members elect to transfer their complying superannuation fund accumulation to a KiwiSaver scheme.
 4. To obtain complying superannuation fund status, a registered superannuation scheme will have to satisfy the requirements for the scheme to be registered before 1 July 2007.

A number of other changes have also been made and will be described in a *Tax Information Bulletin* to be published in 2008.

DETAILED ANALYSIS

Member tax credit (sections KJ to KJ 5 of the Income Tax Act 2004 and sections MK1 to MK8 of the Income Tax Act 2007)

A number of changes have been made to the member tax credit rules as enacted by the Taxation (KiwiSaver and Company Tax Rate Amendments) Act 2007. Section references are to the Income Tax Act 2004 unless otherwise specified.

Creditable membership

The requirements that a person must meet to be eligible for the member tax credit are set out in section KJ 2. New section KJ 2(a) introduces the requirement of having a “creditable membership” of KiwiSaver or a complying fund. Accordingly, a new definition of “creditable membership” has been included in section OB1. The definition provides that when a person joins KiwiSaver or a complying fund, the period of eligibility for the member tax credit begins from the earlier of:

- the first of the month in which contributions are deducted from an employee’s salary or wages; or
- the first of the month in which a contribution is received by Inland Revenue (a voluntary contribution paid directly to Inland Revenue); or
- the first of the month in which securities are allotted by a KiwiSaver scheme or a complying superannuation fund.

Contributions paid to Inland Revenue – transitional rule

A transitional rule applies as a result of the legislative requirement that all contributions must be paid to Inland Revenue during the period 1 July to 30 September 2007. This transitional rule treats membership as beginning on the first of the month in which a provider receives a valid application for membership from a person if contributions are received by either Inland Revenue or the provider during the period 1 July to 31 October 2007.

Amount of member tax credit

The amount of the member tax credit payable is calculated under the formula in section KJ 3. It has been amended to correct a drafting error and to clarify the calculation of the credit. If a person meets the requirement set out in section KJ 2 for the full member credit year (1 July to 30 June), the amount of the credit is the total amount of contributions received during the year up to a maximum of \$1042.86. If the person does not meet the requirements in section KJ 2, the credit is apportioned on the basis of the number of days the person meets the requirements. Two possible formulas for calculating the credit are provided, with the relevant formula depending on whether the amount contributed by the member is more or less than $1042.86 \div 365$ (2.857 per day).

First formula:

$$\frac{\text{member credit contributions}^1}{\text{included days}^2}$$

Second formula:

$$\$1042.86 \times \frac{\text{included days}}{365}$$

If the amount calculated by the first formula is less than $1042.86 \div 365$ (2.857 per day) the amount of the member tax credit is equal to the total amount of that person's contributions for the member credit year (1 July to 30 June). If the amount calculated under the first formula is equal to or greater than $1042.86 \div 365$ (2.857 per day) the amount is calculated by the second formula.

Example 1

Tracey is automatically enrolled in KiwiSaver on 15 April 2008 through her employer. Her eligibility for the member tax credit begins on 1 April (deductions made from salary or wages in April), 91 days before the end of the member credit year (30 June 2008). Tracey makes contributions to her KiwiSaver scheme during this 91-day period totalling \$500 (approximately \$38.00 a week). As the amount that she has contributed is greater than $1042.86 \div 365$ (2.857), the amount of her member tax credit is calculated using the formula:

$$\$1042.86 \times \frac{91 \text{ (included days)}}{365}$$

Tracey's tax credit entitlement for the 2007/08 member credit year is \$260.00 (13 weeks at \$20.00).

Example 2

Mike opts into KiwiSaver through his employer on 26 April 2008. The first contributions from his pay will not be deducted until May, so he makes a voluntary contribution to Inland Revenue that is received on 28 April 2008. Mike's eligibility for the member tax credit begins on 1 April 2008, 91 days before the end of the member credit year (30 June 2008). Mike makes contributions to his KiwiSaver scheme during this 91-day period totalling \$200 (approximately \$15.38 a week). As the amount he has contributed is less than $1042.86 \div 365$ (2.857), the amount of his member tax credit for the 2007/2008 member credit year is equal to the total amount of his member credit contributions for the member credit year = \$200.00 (approximately \$15.38 x 13 weeks).

¹ "Member credit contributions" are the total amount of a person's member credit contributions for all of the person's complying superannuation funds and KiwiSaver schemes for the member credit year.

² Included days are the number of days in the member credit year on which the person meets the requirements in section KJ 2.

Member credit contributions

A new definition of “member credit contributions” is introduced and includes amounts received and held by the Commissioner. These are contributions received and held by Inland Revenue but not on-paid to the provider until after the member credit year. These will count as contributions for calculating the member tax credit for that year. Employer contributions, amounts diverted under a mortgage diversion and amounts refunded are excluded for the purposes of calculating the credit.

Processing claim for credit

Section KJ 4(2) has been amended to provide that upon receipt of a claim, Inland Revenue has 30 working days to process and pay the claim to the provider. Member tax credits are paid to providers on a first-come basis. There is no longer a pro-rating of the payment between providers if the member has more than one provider.

Payment of credit

New subsection KJ 4(3) provides the circumstances in which the Commissioner may make a payment to individual members or to another provider. A final payment may be made to the member or the member’s estate for reasons of serious illness, death or when the member’s account is closed. Inland Revenue will pay the credit to the member’s provider at the time the claim is made. If there is, or will be, a change in provider (a request for transfer), the credit will be paid to the new provider if requested by the first provider.

Allocating the credit

Section KJ 5 (3) has been amended to clarify the rules in relation to allocating the member tax credit. The provider must allocate the member tax credit according to the current investment allocation instructions the member has elected or the investment allocation to which the member has been allocated.

Claiming the credit

The provider must claim the tax credit in the “form prescribed by the Commissioner”. Providers will make a claim after 30 June each member credit year on the basis of the contribution information they hold (and Inland Revenue does not hold) at that date. That will include information such as the amount of contributions received directly by the provider and the amount of contribution subject to a mortgage diversion. Inland Revenue will calculate and pay the credit based on the information received and the contribution information it holds. All contributions for complying funds will, however, need to be received by 30 June to count towards the calculation of the credit in that year as all complying fund contributions are made directly from the employer to the provider. (Inland Revenue does not hold information for complying funds.)

The actual process for claiming the member tax credit is still being developed by Inland Revenue and providers. It will require providers to furnish necessary information to Inland Revenue to enable it to calculate the member tax credit. Inland Revenue will calculate the member tax credit on the basis of such information and will make supplementary member tax credit payments, where appropriate, when additional information is available in relation to money in the holding account.

Providers retain the ability to make supplementary claims for periods for which they have obtained the information needed to make a claim – either when no claim was previously lodged, or when less than the maximum eligible claim has previously been paid. However, because Inland Revenue will be calculating the entitlement to the member tax credit based on information provided to it and also on the qualifying contributions it holds, KiwiSaver providers may not need to make supplementary claims after the end of the member credit year.

As complying superannuation fund providers may not always hold the relevant IRD numbers for their members, an amendment enables complying superannuation funds that do not have a member's IRD number to supply other information to Inland Revenue to assist it in making the payment. If it is unable to make the payment on the basis of the information provided, Inland Revenue will inform the provider so that the provider can write to the member requesting the necessary information. Section 68C (3)(a) of the Tax Administration Act 1994 has been amended to clarify that the IRD number need be provided only if known.

Transfers – information to be provided

Section 56 of the KiwiSaver Act has been amended so that KiwiSaver providers are no longer required to provide information about the amount of the member tax credit received or information about previous claims made by them to a new KiwiSaver provider on transfer. This is because Inland Revenue will hold this information. However, the following details will still need to be provided to another scheme on transfer:

- the value of qualifying contributions received directly;
- mortgage diversion arrangements;
- any periods of ineligibility owing to residence outside New Zealand; and
- the date on which a person first became a member of a KiwiSaver scheme.

Permanent emigration

Clause 14(2) of Schedule 1 of the KiwiSaver Act has been amended to provide that when KiwiSaver members permanently emigrate and transfer all of their funds in their KiwiSaver scheme to a foreign superannuation scheme the nominal value of the credit up to the value of their accumulation in the scheme will be repaid to the Crown.

Compulsory employer contributions

New Subpart 3A of Part 3 of the KiwiSaver Act (sections 101A to 101K) requires an employer to make an employer contribution for each employee who has deductions for KiwiSaver or complying superannuation fund³ contributions from his or her gross salary or wages. This requirement will be phased in as follows:

| From | Employer compulsory contribution rate as a percentage of gross salary or wages |
|--------------|---|
| 1 April 2008 | 1% |
| 1 April 2009 | 2% |
| 1 April 2010 | 3% |
| 1 April 2011 | 4% |

The introduction of compulsory employer contributions will increase the incentive for employees to contribute to a KiwiSaver scheme or a complying superannuation fund by having contributions deducted from their salary or wages.

Existing contributions will count towards the compulsory amount in certain circumstances to prevent employers already making employer contributions to existing registered superannuation schemes from having to make additional compulsory employer contributions.

New section 101B provides rules relating to who should bear the cost of the compulsory employer contributions. In the first instance, compulsory employer contributions will be paid in addition to the employee's gross salary or wages as an additional payment (benefit) on top of existing remuneration. However, from 13 December 2007, employers and employees (or unions) may agree as to how compulsory employer contributions will be funded, provided that agreement is an outcome of good faith bargaining.

General rules for compulsory employer contributions

New section 101A requires employers to pay a compulsory employer contribution for employees if they meet the requirements set out in section 101C (employee requirements).⁴ The requirements are that employees are:

- paid salary or wages from which the employer deducts, or is required to deduct, contributions for their KiwiSaver scheme or complying superannuation fund;

³ A complying superannuation fund is a section within a registered superannuation scheme that has been approved by the Government Actuary as having met certain criteria, such as KiwiSaver lock-in rules and portability.

⁴ An employer contribution is an employer superannuation contribution (specified superannuation contribution) made by an employer to a KiwiSaver scheme or a complying superannuation fund and includes compulsory contributions. It does not include amounts, such as group life insurance, that do not count as a contribution under section 68(2) of the KiwiSaver Act. See the definition of "employer contribution" in section 4 of the KiwiSaver Act. (Note that for the purposes of the Income Tax Act 2007, the term "employer's superannuation contribution" replaces the term "specified superannuation contribution".)

- aged 18 and over;
- not entitled to withdraw an amount from their KiwiSaver scheme or complying fund under the scheme rules that require lock-in (that is, the age of eligibility for New Zealand superannuation or five years of membership, whichever occurs later); and
- not a defined benefit scheme member.

If an employee does not meet any of these requirements, the employer is not required to make a compulsory employer contribution for that employee. This does not prevent an employer making voluntary contributions to an employee's KiwiSaver scheme or complying superannuation fund if the employee does not meet these requirements.

Employers are required to make compulsory contributions if they are required to make KiwiSaver deductions from an employee's salary or wages. For example, if an employee is subject to the automatic enrolment rules but the employer does not make a deduction of KiwiSaver contributions, the employer is still required to pay a compulsory employer contribution for that employee.

A defined benefit scheme member (defined in section 4 of the KiwiSaver Act) is an employee whose employer makes contributions to an existing registered superannuation scheme that is a defined benefit scheme. (The retirement benefits for employees are calculated by reference to their salary or wages.) Compulsory employer contributions are not payable for members of defined benefit schemes if:

- the scheme was registered before 17 May 2007;
- the employer provided access to eligible employees before 17 May 2007; and
- the employee was employed by the employer before 1 April 2008 and the employer makes or has agreed to make contributions before that date.

In addition, an employee will be treated as a defined benefit scheme member in the following circumstances (provided that the foregoing requirements are met):

- The scheme is one that succeeds the scheme that has to be registered by 17 May 2007, provided that all relevant members transferred to that scheme by virtue of section 9BAA of the Superannuation Schemes Act.
- If an employee is covered by a collective agreement in force before 17 May 2007 and expiring after 1 April 2008 that requires the employer to make contributions to that scheme.
- If the employee has changed employment and the new employer is required to make contributions to that scheme on the same basis as the previous employer. This would cover the situation where an employee is treated as a defined benefit scheme member but changes employment and the new employer is required to continue to contribute to that scheme for that employee.

Calculation of compulsory employer contribution

New section 101D sets out the rules for determining the amount of the employer contribution. The amount of the contribution payable by an employer is calculated using the following formula:

Payment of salary or wages multiplied by CEC rate – other contributions – hybrid scheme contributions

The “**payment of salary or wages**” is the amount of gross salary or wages from which the employer deducts or required to deduct an employee’s contribution to a KiwiSaver scheme or a complying superannuation fund.

The “**CEC rate**” is:

- 1% if the payment of gross salary or wages is made for a pay period in the year starting on 1 April 2008;
- 2% if the payment of gross salary or wages is made for a pay period in the year starting on 1 April 2009;
- 3% if the payment of gross salary or wages is made for a pay period in the year starting on 1 April 2010;
- 4% if the payment of gross salary or wages is made for a pay period in the year starting on or after 1 April 2011.

The CEC rate for a year applies only if the whole pay period is in the year specified. For example, if a pay period for an employee spans 1 April 2009, then the 1 percent rate will apply for the employer contributions in respect of the payment of salary or wages for that pay period. The 2 percent rate will apply to the next pay period.

“**Other contributions**” is the total amount that an employer pays (or credits) an employee in relation to payment of gross salary or wages if the amount is:

- (a) an employer contribution made in absence of this section (that is, voluntary contributions to a KiwiSaver scheme or a complying superannuation fund):
- (b) an employer superannuation contribution made to a registered superannuation scheme if:
 - the scheme (or the prior scheme if the scheme is a successor scheme) was registered before 17 May 2007;⁵
 - the scheme provides access to eligible employees before 17 May 2007;
 - the employee is employed by the employer before 1 April 2008 and the employer makes or has agreed to make employer contributions before that date, or the employee is covered by a collective agreement that is in force before 17 May 2007 and expires after 1 April 2008 requiring employer contributions to the registered superannuation scheme; and

⁵ In relation to a successor scheme, all the relevant members have to be transferred by virtue of section 9BAA of the Superannuation Schemes Act.

- the registered superannuation scheme provides that the contributions vest in the employee within five years of becoming a member.⁶
- (c) an employer contribution in relation to an employee who is a member of Parliament, a judicial officer, or a sworn member of the police or a class of employee prescribed in regulations made under section 230A of the KiwiSaver Act.

“**Hybrid scheme contributions**” cover those contributions an employer makes to a scheme where the retirements benefits are calculated by adding to employee’s total contributions a percentage of those contributions. Such schemes are not included in the “defined benefit scheme member” exclusion or in “other contribution”. The amount of the contribution is given by the following formula:

Member’s contributions (the amount of the employee’s contributions for the period to which the payment of gross salary or wages relates) multiplied by the vesting percentage (the percentage of the employee’s total contributions to be added to those contributions five years after the employee first became a member of the scheme).

Employer contributions that are paid from reserves will be treated as employer contributions for the purposes of “other contributions”. Also, the amount of the employer contribution will be the amount payable before the deduction of employer’s superannuation contribution tax (specified superannuation withholding tax).⁷

Example 3

Joe is member of his employer’s existing superannuation scheme and joins KiwiSaver. Joe, the scheme and his employer meet the rules of “other contributions” in section 101D of the KiwiSaver Act. Joe’s employer makes a matching 2% employer contribution to the existing scheme every pay period. His employer will not be required to make compulsory employer contributions in the 2008/09 tax year or 2009/10 tax year as the amount of “other contribution” equals or is greater than the amount of the compulsory employer contribution payable. However, from 1 April 2010 Joe’s employer will be required to make a 1% compulsory employer contribution to his KiwiSaver scheme and a 2% contribution from 1 April 2011 as the contributions to the existing scheme are less the compulsory amount.

Section 101E allows an employee and employer to agree the allocation of compulsory employer contributions between an employee’s KiwiSaver Scheme and complying superannuation fund. If no agreement is reached, the compulsory employer contributions are first allocated to the employee’s KiwiSaver scheme and then to the complying superannuation fund (if any).

⁶ To determine the amount of the contribution that vests within the five-year period when a contribution is paid, the employer is required to calculate, on the basis of the vesting scale in the trust deed, the amount that will vest if the employee is still a member after five years. It is not necessary to adjust amount calculated if the contribution does not actually vest.

⁷ Employer’s superannuation contribution tax from 1 April 2007.

Application of section 101B

Section 101B(1) provides that compulsory contributions⁸ are to be paid in addition to an employee's gross salary or wages used in section 101D(3) (on top of remuneration). Subsections (2) and (3) provide that a contractual arrangement of parties to an employment relationship cannot defeat the intention of subsection (1). That is, if the contractual arrangements specify that the employee must pay the cost of compulsory employer contributions from the employee's existing salary or wages, the arrangement has no effect.

However, on or after 13 December 2007, parties to an employment relationship are free to agree contractual terms and conditions that ignore the "on top of" remuneration requirement and the provisions of this section do not apply. Subsection (4) inserts an avoidance of doubt provision so that the duty of good faith as described in the Employment Relations Act 2000 always applies when parties to an employment relationship bargain for terms and conditions relating to compulsory contributions and associated matters, such as the employer tax credit.

Enforcement of the payment of compulsory employer contributions to a KiwiSaver scheme

Sections 93 and 101F(1) require employer contributions to a KiwiSaver scheme to be paid to Inland Revenue at the same time as employee contributions via the PAYE system. Other amounts that do not count as contributions under section 68(2) of the KiwiSaver Act (such as group life insurance) must be paid direct to the provider.

The payment of compulsory employer contributions via Inland Revenue provides a mechanism to allow Inland Revenue to police the payment by employers. Non-payment of compulsory employer contributions will be subject to current collection and enforcement practices. Section 216 of the KiwiSaver Act has been amended to provide a specific penalty for employers that do not comply with the requirement to pay compulsory employer contributions. From 1 April 2009, section 216 will be repealed and employers will be subject to the penalties that apply for the non-compliance of other PAYE-type tax obligations. Furthermore, the definition of tax in section 3 of the Tax Administration Act 1994 will be amended from 1 April 2008 to include compulsory employer contributions. This will allow the Commissioner to use existing collection powers.

Enforcement of the payment of compulsory employer contributions to complying superannuation funds

Section 101F(2) requires compulsory employer contributions to a complying superannuation fund to be paid direct to the provider. The payment must be made no later than one month after the payment of the salary or wages to which the contribution relates.

⁸ A compulsory contribution is an amount of compulsory employer contribution calculated by section 101D ignoring the application of section 101D(5)(d).

In keeping with current practice, it will be the responsibility of the provider to ensure compulsory employer contributions from an employer are made. It is expected that the current practice of employers certifying that all employer contributions have been made will continue. New section 101H requires a provider to give notice to an employer requesting payment if the provider is aware that the employer has failed to pay compulsory employer contributions. A copy of that notice must be provided to the Government Actuary. If payment does not occur within one month of the notice being given and the amount of the unpaid contributions is more than \$500, the provider must give notice to the Government Actuary of the default.

New Section 101I specifies that once notification has been received, the Government Actuary must determine the amount of any short payment. The Government Actuary can use existing powers under the KiwiSaver Act to investigate the matter and determine the amount outstanding. Once the Government Actuary has determined the amount of any short payment, the employer will be notified of the amount and will have 28 days to pay or dispute the amount. If the amount remains unpaid and no objection has been received, the amount will be transferred to Inland Revenue for collection. The amount will be due and payable to the Commissioner 20 working days after the notice is received. The definition of “tax” in section 3 of the Tax Administration Act 1994 is amended to include compulsory employer contributions to a complying superannuation fund. This will allow the Commissioner to impose penalties and use existing collection powers from 1 April 2009 when such debts are referred to the Commissioner for collection.

Rules for providers

Section 101G requires the provider to allocate the compulsory employer contributions across the investment products that the member has subscribed to or been allocated. Such contributions are to vest immediately.

In addition, section 101G(3) requires the provider to notify Inland Revenue the date that a member will be entitled to withdraw his or her accumulated interest in the scheme. This must be done within two months of the person becoming entitled to withdraw the accumulated interest. Inland Revenue must notify the member’s employer of that date so that the employer can cease making compulsory employer contributions.

Withdrawal of compulsory employer contributions

The KiwiSaver Act allows a member to withdraw employer contributions that have vested in an employee in the following circumstances:

- to assist with the purchase of the member’s first home (which includes second chance buyers)⁹;
- for significant financial hardship;
- for serious illness;

⁹ A second chance buyer is a previous home owner who is in the same financial situation as first-home buyers in terms of income and assets. Second chance home buyers will apply to Housing New Zealand for a determination of whether they are in the same financial situation as a first-home buyer.

- on permanent emigration from New Zealand;
- on the death of the member;
- as required by any statute such as an order made under section 31 of the Property (relationships) Act 1976; and
- upon the age of eligibility of New Zealand superannuation of five years of membership, whichever is the later.

As section 101G(2) provides that compulsory employer contributions will vest immediately in the member, such contributions will be able to be withdrawn in the foregoing circumstances. The KiwiSaver Act prevents employer contributions being diverted under a mortgage diversion facility, and this applies for compulsory employer contributions.

Shareholder-employees of a close company

Employers of shareholder-employees of a close company will be required to make compulsory employer contributions for them if their remuneration from the company is subject to PAYE and they are having KiwiSaver contributions deducted from that remuneration. Salary or wages for the purposes of the KiwiSaver Act excludes salary or wages or other income to which section OB 2(2) (meaning of source deduction payment: shareholder-employees of close companies) applies and, as a result, only salary or wages subject to PAYE will give rise to a compulsory employer contribution.

Private domestic workers

The KiwiSaver Act has been amended to clarify how KiwiSaver applies to private domestic workers, who are required to pay their own PAYE. As a result, private domestic workers can be both an employee and employer under the KiwiSaver Act, and the Act has been clarified to reflect this. Private domestic workers can deduct KiwiSaver contributions from their salary or wages and can choose to be an employer for the purposes of compulsory employer contributions. If they pay compulsory employer contributions, they will be entitled to the employer tax credit.

Employer contributions counting towards the employee contribution rate

The KiwiSaver Act allowed employer contributions to count towards the employee contribution if the parties agreed. With the advent of compulsory employer contributions, this provision was to be amended from 1 April 2008 to require a minimum employee contribution of 4% unless the transitional rates in proposed section 66A applied (limited to employees who had already entered into such an agreement). The Finance and Expenditure Committee recommended that the transitional rule be extended to all employees if their employer agreed to contribute at the 4% contribution rate.

New section 66A allows employees to enter into an agreement with their employers that the employer will contribute at least 2% towards the employee's 4% minimum contribution rate, from 1 April 2008 until 31 March 2011, if:

- the employer and employee agree that they will use the transitional rates of contribution;
- the employer contribution for the payment of salary or wages is equal to or greater than the relevant transitional rate for the employee; and
- the employer contribution vests in the employee immediately after it is made.

The minimum contribution rate for employees whose employer agrees to contribute towards their contribution rate will be:

| Pay period | Minimum employee contribution | Minimum employer contribution | Total contribution |
|---------------------------|--------------------------------------|--------------------------------------|---------------------------|
| From 1 April 2008 | 2 percent | 2 percent | 4 percent |
| From 1 April 2009 | 2 percent | 2 percent | 4 percent |
| From 1 April 2010 | 3 percent | 3 percent | 6 percent |
| From 1 April 2011 onwards | 4 percent | 4 percent | 8 percent |

Employer tax credit (sections KJ6 to KJ10 of the Income Tax Act 2004)

New section MK 1(2) of the Income Tax Act 2007 (section KJ 6 of the Income Tax Act 2004) provides a tax credit to employers to help offset the costs of making matching compulsory employer contributions to an employee's KiwiSaver scheme or a complying superannuation fund. The tax credit will be equal to the lesser of the employer's contribution or \$20 a week for each employee. Sections MK 9 to MK 16 of the 2007 Act (sections KJ 7 to KJ 12 of the 2004 Act) set out the eligibility rules and how the credit is to be applied. To minimise compliance costs and cash-flow implications of compulsory employer contributions, the payment of the tax credit is integrated into the PAYE remittance process. It is expected that employers will pay Inland Revenue a net amount after deducting the tax credit from their PAYE liability for the payment period. (Section references are to the 2007 Act unless otherwise specified.)

This tax credit can be claimed by any employer (including tax-exempt entities such as charities) provided the employer is making an employer contribution to a KiwiSaver scheme or a complying superannuation fund for an employee who meets the requirements in section MK 9.

The employer tax credit applies to employer contributions made to a KiwiSaver scheme or a complying superannuation fund from 1 April 2008.

Entitlement

New section MK 1(2) allows an employer who makes a contribution on behalf of an employee a tax credit for the payment period equal to the amount calculated under section MK 10. To be eligible for the credit the employer must meet the requirements in section MK 9.

Eligibility requirements

To be eligible for the employer tax credit, the employer must:

- (a) pay an employer contribution in respect of an employee who is aged 18 or over and is not entitled to withdraw an amount from a KiwiSaver scheme or complying superannuation fund under the scheme rules that require lock-in (that is, the age eligibility for New Zealand superannuation or five years of membership, whichever occurs later);
- (b) provide details of the amount of the credit in an employer monthly schedule or remittance certificate (although that is not required if subsection (2) applies); and
- (c) be an employer to which KiwiSaver applies (that is, be a employer who is tax-resident in New Zealand or, if not tax-resident, be an employer who carries on a business from a fixed establishment in New Zealand or chooses to apply the KiwiSaver Act on behalf of employees).

Subsection (2) applies when the employer has unpaid compulsory employer contributions.

Amount of credit

The amount of the tax credit allowable to an employer is equal to the lesser of:

- the amount of the employer contributions for the employee for the payment period; and
- the amount calculated using the formula – \$20 multiplied by weeks in payment period.

“**Weeks in payment period**” means the number of weeks for the payment of the employee’s salary or wages for which the employee meets the eligibility requirements in paragraph (a) above, including weeks in that period in which no employer contribution is made. Parts of a week are expressed as a decimal. A “payment period” means that period in which PAYE is withheld in relation to an employee and includes a period of a month or a period of 1st to the 15th of a month and a period from the 16th to the end of a month.

For example, if during a payment period for the month of April an employer makes employer contributions of \$50, the amount of the tax credit will be \$50 because the actual employer contributions are less than the amount calculated by the formula (\$85.71). If the actual employer contributions were more than \$85.71, the amount of the tax credit for that month would be limited to \$85.71.

The tax credit is available in respect of both voluntary and compulsory employer contributions to a KiwiSaver scheme or complying superannuation fund.

Application of tax credit

New sections MK 11 to MK 13 set out the rules relating to how the tax credit will be applied. The tax credit is integrated into the PAYE remittance process so that the value of the credit is given to employers at the same time as the employer is required to remit the contributions to providers or Inland Revenue.

Section MK 11 provides that the tax credit arises when the PAYE is due for the month or the date of payment of PAYE for a private domestic worker in which the employer contributions were made. For example, tax credits for contributions made during April 2008 for a monthly payment period would arise on 20 May 2008, being the payment date for that period. Subsection (2) deals with the situation when subsection MK 9(2) applies, which covers short payment of compulsory employer contributions to a complying superannuation fund or a KiwiSaver scheme.

Sections MK 12 and MK 13 deal with the use of the tax credits to offset employer contributions and other PAYE liabilities.

The tax credit calculated for a payment period is used as follows:

- first, to pay KiwiSaver compulsory employer contributions due for that period or amount owing to a complying superannuation fund referred to in a notice received by the Commissioner under section 101I(5) of the KiwiSaver Act;
- second, to pay voluntary KiwiSaver employer contributions for that payment period;
- third, to pay any other amounts payable for that payment period by the employer;
- fourth, to pay any other amount payable by the employer to the Commissioner (arrears of an amount due under an Inland Revenue Act); and
- fifth, refunded to the employer.

From 1 April 2009, new section 101I of the KiwiSaver Act requires the Government Actuary to send a notice to Inland Revenue detailing the amount of compulsory employer contributions to a complying superannuation fund that is owed by the employer. When such a notice is received by Inland Revenue or there is a short payment of compulsory employer contributions to a KiwiSaver scheme, new section MK 13 allows the employer tax credits used under sections MK 12(1)(b) or (c) to be used to meet that amount owing. When this occurs, a tax liability of the amount of the credits used becomes payable by the employer to the Commissioner.

Miscellaneous provisions

New section MK 14 provides that if employer contributions are refunded as a result of an employee opting out of KiwiSaver, the amount of any tax credits claimed in respect of such contributions is refundable to the Commissioner.

New section MK 15 provides that if someone is employed by a number of employers who are associated for tax purposes, the associated employers will be considered as one employer for the purposes of claiming the tax credit. This is to prevent associated employers claiming more than one credit for the same employee.

Private domestic workers who are employers for the purposes of the KiwiSaver Act are treated as paying salary or wages to themselves in the capacity of an employee for the purposes of the employer tax credit rules. This means that they are able to claim the credit if employer contributions are made.

Section DC 7 of the Income Tax Act 2007 (contributions to employees' superannuation schemes), which allows an employer a deduction for contributions to an employee's superannuation scheme, is amended to limit the amount of the deduction for contributions to a KiwiSaver scheme or a complying superannuation to the amount for which no credit was claimed.

Definition of “salary and wages” (section 4 of the KiwiSaver Act)

The definition of “salary and wages” in section 4 of the KiwiSaver Act has been amended in the following ways:

- from 1 July 2007, to clarify that all weekly compensation and paid parental leave payable under Part 7A of the Parental Leave and Employment Protection Act 1987 are salary or wages for the purposes of KiwiSaver; and
- from 1 April 2008, to exclude the value of benefits by way of the provision of board or lodging or the use of a house or quarters, or the payment of allowances instead of such benefits (para (b)(i) of the definition of the definition of salary or wages in the Income Tax Act 2004);
- to exclude a redundancy payment as defined in the Income Tax Act 2004;
- to exclude expenditure on account of an employee and allowances if those amounts are overseas accommodation and other costs of living.

For the purposes of compulsory employer contributions, the following are not salary or wages:

- all weekly compensation and paid parental leave;
- weekly compensation paid by an employer, unless the employer chooses to treat such payments as salary or wages.

This means that these payments are not subject to compulsory employer contributions.

For contributions to complying funds, bonuses, commissions and other amounts that are not included in gross base salary or wages are excluded. This enables employers that contribute to complying funds to apply current practice (gross base salary, or a variant of this) as a contributions multiplier. This change means non-regular payments are excluded and contributions, including compulsory employer contributions, are calculated on the same gross base salary basis as an employee's contribution. However, employers will have to use gross salary and wages as a basis for contributions for those employees that choose to opt into KiwiSaver.

Initial and confirmed back-dated validation of invalid membership (sections 18 and new section 59 of the KiwiSaver Act 2006)

Invalid KiwiSaver enrolments occur in a range of circumstances. This can happen, for example, when people join KiwiSaver who are not entitled to because they do not meet the residency requirements. Alternatively, they could be incorrectly automatically enrolled, perhaps because they are under 18 years of age or over the New Zealand superannuation qualification age. A new subpart 4 (sections 59A – 59D) has been added to Part 2 of the KiwiSaver Act (allocation of people to KiwiSaver Schemes) to provide rules for invalid KiwiSaver enrolments.

Section 59A of the KiwiSaver Act provides for the circumstances in which an enrolment is invalid and to which the invalid enrolment rules apply. They are when:

- a person does not meet the requirements of section 6 of the KiwiSaver Act – that is, at the time the person was automatically enrolled or opted in, he or she is not living or normally living in New Zealand¹⁰ and is not a New Zealand citizen or is entitled in terms of the Immigration Act 1987 to be in New Zealand indefinitely; or
- a person who does not meet the requirements of the automatic enrolment rules has been automatically enrolled – for example, when the person is less than 18 years of age or is a casual employee; or
- a person who is not entitled to opt in to KiwiSaver does so – for example, because the person is over the New Zealand superannuation qualification age or is already a member of a KiwiSaver scheme.

New section 59B provides that the Commissioner or the relevant provider must be notified of an invalid enrolment as soon as practicable after it is discovered. The section also provides that, for a period of time, providers are able to treat as valid enrolments that have been identified as invalid in as far as the administration of the fund is concerned. The time period for initial back-dated validation begins on the earliest of:

- the day the Act applied; or
- the automatic enrolment rules applied; or
- the opt-in rules applied to the person.

The time period ends on the earliest of:

- three months after the mistake was discovered by the KiwiSaver provider; or
- three months after the provider was notified by the Commissioner or other person; or
- the day that the provider pays the member's accumulation for the person to the Commissioner.

¹⁰ Excluding state services personnel serving outside New Zealand, employed on New Zealand terms and conditions and serving in a jurisdiction where offers of KiwiSaver scheme membership are lawful. Prior to the date of enactment, the requirement was that the member be personally present in New Zealand at the time of enrolment.

New section 59C provides for the validation of a member's enrolment by the end of the time period of initial back-dated validation provided in section 59B if the person meets the rules for membership. This means that all persons who subsequently meet the membership criteria will have their membership validated. In the case of persons who should not be subject to the automatic enrolment rules, enrolment will be validated if they do not opt out and they are eligible to be a member.

This section will apply if at the time during the period specified in new section 59B, persons are eligible to be a member because they meet the requirements of section 6 and are:

- less than the New Zealand Superannuation qualification age (65 years of age); and
- have not opted out under the opt-out provisions in section 18, which have been extended to include persons invalidly automatically enrolled – the invalid enrolment will be validated by the Commissioner and the Commissioner must notify the provider of this.

Example 4

Sam finished school when he was 17 and started working for a builder. His employer automatically enrolled him into KiwiSaver. Six months later Sam's KiwiSaver provider became aware of the fact that even though he was now 18, at the time he was automatically enrolled, he was only 17 years old (and the automatic enrolment rules should not have applied to him), so he had been invalidly enrolled. Sam will be validated as a member and remain enrolled as the opt-out period has expired.

New section 59D provides for a refund process that will apply if the time period of initial validation ends and confirmation of backdated validation under section 59C has not occurred. The section sets out what the provider and Commissioner must do.

The provider must pay the member's accumulation to the Commissioner and immediately provide the Commissioner with:

- notice of the amount of the contributions received by the provider directly and when they were received;
- the amount paid out under mortgage diversion and when paid; and
- the amounts of any permitted withdrawals, when they were paid, their type and the amount of any Crown contribution in the permitted withdrawal.

The Commissioner must refund:

- the amount of the person's contributions received by the provider minus any crown contribution (such as the member tax credit) and amounts diverted under mortgage diversion or paid out by the provider as a permitted withdrawal; plus
- any amount held by the Commissioner (but not yet passed to the provider) net of interest.

The total amount of contributions refunded will include interest. Interest is calculated using the formula in section 87. For the purposes of the calculation of interest on refunds arising from invalid KiwiSaver enrolments, “interest period” is defined as beginning on the day the Commissioner or the provider received the contribution and ending on the day the Commissioner pays the refund.

Section 59(D)(4) provides that the refund is to be made to the person, the person’s employer, the Crown or any other person that made the contribution. The Commissioner can make the refund in proportion to the Commissioner’s best estimate of what they contributed, less amounts diverted under mortgage diversion or paid as a permitted withdrawal.

Section 59(D)(5) provides for the treatment of members’ accumulated interest paid to the Commissioner by the provider and any contributions in the holding account. The money is treated as public money, and the Commissioner is required to pay it into the Crown Bank Account.

Example 5

After Kate had completed her final year of school she started working at her local bakery over the summer before starting university. Kate’s employer had automatically enrolled her into KiwiSaver. Two months later Kate became aware of the fact that had been automatically enrolled. As she was only 17 years old (under the age of eligibility for KiwiSaver membership) the enrolment was invalid.

Kate had already turned 18 by the time she became aware of the fact that she had been invalidly enrolled. This meant her enrolment could be validated *or* Kate could choose to apply for opt-out under section 18 (extension period). An opt-out has to be made in the period that ends three months after the date on which the Commissioner receives the first contribution in respect of Kate.

Regulatory regime for KiwiSaver and complying superannuation funds

A number of changes have been made to the regulatory regime for KiwiSaver and complying superannuation funds. The key changes are noted below and the remaining changes will be covered in a *Tax Information Bulletin* to be published in 2008.

Member statements

New section 125A of the KiwiSaver Act requires the trustees of KiwiSaver schemes and complying superannuation funds to provide annual personalised statements to each member in the scheme. The statement will need to include, at a minimum, information relating to the contributions received by the scheme on behalf of members and the value of the members’ accumulation at the end of the year.

Register of complying superannuation funds

Section 158 of the KiwiSaver Act has been expanded to enable the KiwiSaver register also to include a sub-register of complying superannuation funds. The information recorded on the sub-register will be largely similar to the information recorded in respect of KiwiSaver schemes, and will include contact details for trustees, the date of approval of complying fund status and annual financial balance dates. The details to be included in the register of complying funds are specified in section 161 of the KiwiSaver Act. The register will apply from 1 April 2008.

Unreasonable fees

The definition of “complying fund” rules in section OB 1 of the Income Tax Act 2004 is amended to include a reference to rule 2 in Schedule 1 of the KiwiSaver Act. As such, all complying superannuation fund providers are required to ensure that the fees charged for membership in the complying superannuation fund are not unreasonable. Breach of this rule will amount to a breach of section 35 of the Superannuation Schemes Act 1989 and may be enforced through the provisions in the Superannuation Schemes Act that allow the Government Actuary to direct, de-register or order the wind-up of a scheme. The generic appeals processes in the Superannuation Schemes Act will also apply. An amendment has been made to section 40 of the Superannuation Schemes Act that enables a Court to enforce the requirement that fees not be unreasonable.

Notification of fee changes

An amendment has been made to both the KiwiSaver Act and the Superannuation Schemes Act to require trustees of a scheme to notify the Government Actuary of any changes to the fees that are being charged to members in that scheme. Section 189B of the KiwiSaver Act and section 39 of the Superannuation Schemes Act requires a trustee of a scheme to notify the Government Actuary of any changes to the fees charged for membership in a complying superannuation fund or a KiwiSaver scheme. There has been a corresponding amendment to section 40 of the Superannuation Schemes Act and section 189C of the KiwiSaver Act that enables a court to enforce the unreasonable fees requirements. This amendment has replaced the provisions in clause 2 of Schedule 1 of the KiwiSaver Act that allowed enforcement by the Court. The prohibition against unreasonable fees, however, is still contained in clause 2 of Schedule 1 of the KiwiSaver Act.

Responsible investment

New section 205A has been introduced to require all KiwiSaver schemes and complying superannuation funds to disclose their approach to responsible investment. The disclosure of this approach must be in the form required by the KiwiSaver Act. The Act specifies that the disclosure must be in the investment statements of the scheme and must be included at the end of the “who is providing it for me?” section of the investment statement. The disclosure statement must be in the form prescribed by the section. Failure to comply with this requirement is treated as a failure to comply with the Securities Regulations 1983. This allows the Securities Commission to monitor and enforce compliance with this provision.

Transfers and insurance

Section 9D of the Superannuation Schemes Act has been amended to enable schemes that provide insurance benefits that are linked to superannuation accumulation to reduce those insurance benefits if members elect to transfer their complying superannuation fund accumulation to a KiwiSaver scheme. The insurance benefit may be reduced by an amount that is proportionate to the amount that is transferred out of the complying superannuation fund to a KiwiSaver scheme. For example, if a complying superannuation fund member has an accumulation of \$100,000 and elects to transfer \$50,000 of that accumulation to a KiwiSaver scheme, the complying superannuation fund may reduce the life insurance benefit attached to that member's account by \$50,000.

Further amendments

A number of other amendments have also been made to the KiwiSaver Act, including:

Application

Section 6 of the KiwiSaver Act is amended so that the Act applies to people who, at the time they become subject to the automatic enrolment rules or opt in are, or normally are, living in New Zealand. This amendment applies from the date of assent.

Excluding casual employees from the automatic enrolment rules

Section 12 of the KiwiSaver Act 2006 has been amended to exclude casual employees from the automatic enrolment rules. "Casual employment" is defined by reference to the Holidays Act 2003 as employment that is "intermittent or irregular". The effect is that if employees are paid holiday pay regularly with their salary or wages they will be excluded from automatic enrolment. Those employees can continue to opt in to KiwiSaver, either by providing a deduction notice to their employer or by contracting directly with a scheme provider.

Effect of opting in by employees

Section 36 of the KiwiSaver Act is amended to clarify that persons opting in via a provider must specify the name of their employer if they are employees, thereby clarifying that deductions are required from salary and wages.

Refund of initial contributions

Section 113 of the KiwiSaver Act is amended so that in respect of applications for a refund of initial contributions held in the Inland Revenue holding account on the grounds of significant financial hardship, the Commissioner will have the authority to consider whether alternative sources of funding have been explored and to limit the amount withdrawn.

Restrictions on transactions

New section 117B of the KiwiSaver Act imposes investment restrictions on KiwiSaver schemes with fewer than 20 members. For the purposes of determining the number of members, a person associated with a member under section OD 8(3) of the Income Tax Act will be treated as one person. This provision will:

- require a transaction between the scheme provider and a person associated with either the provider or a member to be at market value;
- limit to 5% of the scheme's assets, investments related to or managed by the provider (other than in their capacity as a provider), a member, or a person associated with a provider or member; and
- prevent a provider from lending money or providing financial assistance to a member or a person associated with the provider or member.