January 2008

KiwiSaver – Legislation finalised for the new compulsory employer contribution regime

1. Introduction

The KiwiSaver legislation announced in the May 2007 Budget was finally passed into law in December 2007. In the end there were no major changes to the Budget announcements – just refinements.

In this newsletter, our sixth on the subject of KiwiSaver, we:

- recap on the 2007 year,
- consider the issues facing employers,
- summarise the key changes made to the draft bill,
- comment on the tricky issue of total remuneration,
- assess the value of the KiwiSaver tax incentives,
- consider the issues of how employers can best respond to the requirement to make compulsory contributions from 1 April 2008,
- note some investment issues,
- mention KiwiSaver seminars, and
- restate some of the basic provisions of the KiwiSaver Scheme.

2. Recap of 2007

Before considering the details and the implications of the new legislation, a brief recap of the events of 2007 provides necessary context.

It was a very busy year, when superannuation started again to play a major role in an employee's remuneration.

KiwiSaver commenced on 1 July, with the automatic enrolment of new employees. Enrolment rates have been higher than expected.

The new PIE tax regime commenced on 1 October and has been a major source of administrative disruption to most schemes albeit that the benefits of the lower tax payable under the new regime will be realised and appreciated in time. In January 2008 we will see the first set of investment results from the providers for their different funds.

3 Issues for employers

We see a number of issues that have to be resolved.

- How can an employer best work with its employees to take full advantage of the tax benefits on offer.
- For an employer with no existing scheme, should the employer just meet the minimum required employer contributions or alternatively structure their employees' future remuneration to enable them to get the tax benefits from 1 April 2008. In addition, what is the best way to use the transitional minimum contribution rules which will allow employees for the first 2 years to contribute at just 2% compared with the normal rate of 4%.
- For an employer with an existing scheme, should the employer restructure the current arrangements to enable their employees to easily capture the maximum KiwiSaver tax benefits and still contribute to the existing scheme. Such employers may need to review the reasons why they already have a scheme and whether they wish to continue to provide employee benefits to employees over and above the 'average' provision.
- How to ensure that employees cannot double dip and use the legislation to require the employer to make contributions to both KiwiSaver and the existing scheme.

Employers will need to deal with each of these issues in a cost effective manner.

Employers considerations and planning will be made in the knowledge that KiwiSaver is here to stay and will in future be a major part of the retirement savings for many employees.

4. Key changes made to the draft bill

(i) Double Dipping

From 1 April 2008, employers are required to make compulsory contributions to KiwiSaver in respect of employees who contribute to KiwiSaver. The initial contribution level is 1% of gross salary or wages from 1 April 2008, rising to 4% from 1 April 2011.

However, in certain circumstances the contributions that employers make to existing arrangements can count towards their compulsory employer KiwiSaver contributions. This is to prevent employees 'double dipping', a situation which would require the employer to contribute to the existing arrangement and to make compulsory KiwiSaver employer contributions for the employee.

A number of changes have been made to stop double-dipping.

- Under the original bill, the employee had to have been employed by the employer before 1 April 2008. Under the legislation as enacted, all employees covered under a collective agreement that was in force before 17 May 2007 and which expires after 1 April 2008 are covered under the double dipping rules.
- The requirement that the employer contribution must vest immediately has been relaxed. Under the legislation as enacted, employer contributions that vest within five years can count towards the compulsory KiwiSaver contribution.
- The position with respect to defined benefit schemes has been changed.

It is important to note that compulsory employer KiwiSaver contributions are still required for employees who join after 1 April 2008, unless they are covered under a collective agreement that was in force as at 17 May 2007 and expires after 1 April 2008. It follows that double dipping will still be an issue for such "new" employees.

The double dipping rules for members of defined benefit schemes have changed significantly. In the original bill, compulsory employer KiwiSaver contributions were not required for existing employees if the actuarial value of the additional benefit accruing each year that is derived from the employer's contributions is at least equal to the required compulsory contribution and that actuarial value vests immediately in the employee. These provisions no longer apply.

Broadly, all defined benefit schemes (including hybrid schemes) are now covered and protected against double dipping in respect of existing members.

The full double-dipping provisions are included in Appendix A.

(ii) The definition of salary or wages

For KiwiSaver - Under the original draft legislation, the definition of "salary or wages" used to determine KiwiSaver contributions was wide ranging and included items such as redundancy benefits.

Redundancy benefits are now excluded from the definition, as are accommodation benefits or allowances and overseas living costs.

Employee KiwiSaver contributions are required to be paid in respect of ACC payments and paid parental leave. However, compulsory employer contributions are not required to be paid on these employee income elements.

For Complying Funds - The definition of "salary or wages" for the purposes of determining contributions to Complying Funds now excludes "bonuses, commissions and other amounts not included in an employee's gross base salary or wages".

This definition is consistent with the definition of pensionable salary in most existing schemes.

(iii) KiwiSaver contributions – transitional rules

The minimum compulsory KiwiSaver employer contribution starts at 1% of 'salary or wages' for the year commencing 1 April 2008 and increases (in steps of 1%) to 4% for the year commencing 1 April 2011. Employees who join KiwiSaver either contribute at the standard 4%, or can elect to contribute at a higher rate of 8% of salary or wages.

However, the legislation contains transitional provisions which allow employees to contribute at a lower level than the standard 4% provided that the employer also contributes at certain minimum levels. The required minimum contribution levels under these transitional rules are given in the following table:

Year	Minimum contribution		
commencing	Employee	Employer	Total
1 April 2008	2%	2%	4%
1 April 2009	2%	2%	4%
1 April 2010	3%	3%	6%
1 April 2011 and later	4%	4%	8%

Of note, for the two years commencing 1 April 2008 employees can contribute at just 2% if the employer makes a similar level of contribution.

The transitional provisions can be used only by agreement between an employee and the employer and can be used irrespective of whether the employee joins KiwiSaver before or after 1 April 2008.

5. Total Remuneration

For employees who are remunerated by way of a total remuneration package, the question arises as to whether the compulsory KiwiSaver employer contribution has to be:

- paid by the employer on top of the current total remuneration package enjoyed by the employee, so that the employee receives an increase in total remuneration; or
- can come out of the employee's total remuneration, so that the total package remains the same but, all other things being equal, the employee's take-home pay reduces.

The legislation clarifies this issue. As enacted, any employment agreement entered into before the legislation was passed (13 December 2007) that enables the compulsory employer KiwiSaver contribution to be paid out of the total remuneration package of the employee will be null and void. As a consequence;

- initially, compulsory employer contributions will be in addition to current remuneration,
- after 13 December 2007, employees and employers are free to agree contractual terms and conditions that enable compulsory employer contributions to be included within the total remuneration package, and
- in the absence of any such agreement, the compulsory employer contributions are treated as being in addition to current remuneration.

The most likely scenario is that the compulsory employer contributions will be included in the employee's total remuneration package when the employee's remuneration terms are next renegotiated with the employer.

6. Value of KiwiSaver tax benefits

These tax benefits are substantial and are summarised below.

- A tax credit for employees that matches their contributions into a KiwiSaver scheme (or a complying fund), to a maximum of $20 each week (some $1,040 each year) from 1 July 2007.
- A reduction in the tax rate on the investment income of KiwiSaver schemes from 33% to 30% with effect from 1 April 2008 (which is consistent with the reduction in the company tax rate).
- A tax credit for employers to reimburse the matching of each employee's contributions into a KiwiSaver scheme or a complying fund, to a maximum of $20 each week (some $1,040 each year) from 1 April 2008.
- No SSCWT payment requirement for employer contributions up to the lesser of the employee's KiwiSaver contribution level or 4% of salary and wages.
- A Government fee subsidy, set at $40 for each member in each year.
- A Government grant of $1,000 on an employee's initial entry into KiwiSaver.

With the exception of the employer tax credit, the value of each of these benefits is compared to the value of the same contributions paid to an existing scheme in the following table. We have shown the values for a 35 year old employee currently on an annual salary of $50,000 (so entitled to access the KiwiSaver savings for 30 years).

Accumulated Funds

	KiwiSaver		Non-KiwiSaver	
	$000	%	$000	%
$1,000 Kickstart	6	1		
Employee conts	231	41	231	60
Employer conts (net)	155	28	155	40
SSCWT rebate	76	14		
Member tax credit	85	15		
Fee subsidy	3	1		
Total	556	100	386	100
Today's dollars	265		184	

The calculations assume salary inflation of 3%, SSCWT of 33%, interest of 6% (net of tax) and CPI inflation of 2.5%, in each year.

The table shows that:

- in today's dollars, the KiwiSaver scheme benefits accumulate to $265,000 while the non-KiwiSaver scheme benefits accumulate to $184,000, and
- for the KiwiSaver scheme, the employee contributions account for 41% of the total benefit, while employer contributions and the 'extra' benefits each account for around 29%.

As an aside, we comment that an employer who is promoting KiwiSaver to their employees may wish to consider why some employees do not join, then take steps to address the advised concerns.

7. Responses to compulsory contributions

First some initial comments:

- Paying employees part of their overall remuneration as contributions to a KiwiSaver scheme is now tax effective.
- However this does require employees to contribute directly to a scheme up to a rate of 4%, which requires employees to forgo part of their take-home pay, as shown in the illustration below.

	Without salary sacrifice	Salary sacrifice with KiwiSaver
Gross salary	$50,000	$48,077
Superannuation		
Employee	0%	4%
Employer	0%	4%
Total package	$50,000	$50,000
Tax		
Income tax	$11,370	$10,735
SSCWT	$0	$0
Take-home pay	$38,630	$35,418
Total net package	$38,630	$39,265

With salary sacrifice, although the take-home pay decreases by 8.3%, the total remuneration package increases by 1.6%.

- Employees' responses to whether they join KiwiSaver will depend in part on their age, with younger members attracted by the first home subsidy on offer and older members more aware of the need to put money aside for retirement (which may be accompanied by them being in a better financial position to do so).
- Whatever the decision, there is value in communicating the KiwiSaver benefits.

A key issue for employers is how to maximise the tax credits available. The following table summarises the real cost to an employer of making increasing levels of KiwiSaver contribution for employees on various salary levels.

Cost of employer contributions

		Year 1	Year 2	Year 3	Year 4
Contribution		1%	2%	3%	4%
Salary $40,000					
Contributions	$	400	800	1,200	1,600
Tax Credit	$	400	800	1,040	1,040
Net Cost	$	0	0	160	560
As % of salary		0.0%	0.0%	0.4%	1.4%
Salary $50,000					
Contributions	$	$500	1,000	1,500	2,000
Tax Credit	$	$500	1,000	1,040	1,040
Net Cost	$	$0	0	460	960
As % of salary		0.0%	0.0%	0.9%	1.9%
Salary $100,000					
Contributions	$	1,000	2,000	3,000	4,000
Tax Credit	$	1,000	1,040	1,040	1,040
Net Cost	$	0	960	1,960	2,960
As % of salary		0.0%	1.0%	2.0%	3.0%

We would note that:

- for an employee earning $40,000, the net cost to the employer for a 4% contribution is 1.4%, and for a 1% and 2% contribution is nil (the cost is fully covered by the tax credit), and
- for the employee earning $100,000, the net cost to the employer for a 4% contribution is 3% and for a 1% contribution is nil.

Employers with no existing scheme - We see the issues for such employers as follows:

- The employer can either pay the minimum compulsory contributions required or actively encourage employees to join a scheme by promoting KiwiSaver, which could include selecting a preferred provider.
- Where the employer is prepared to take a proactive stance, an issue is whether to contribute at a rate higher than the required minimum. However, the time period for this stance is only until 2011.
- If the employer has been providing other employee benefits such as life insurance or health insurance, a question arises as to whether this remains the best option for spending the employer's dollars. One option is to continue these benefits for existing employees, but for new employees capture the tax benefits of the KiwiSaver scheme instead.
- While clearly many employers will decide to pay only the minimum required, the opportunity exists to do more for employees with part of the cost being met by Government. It is in this situation that the ability of the employer to share the initial 4% required contribution comes into play. As shown in the table in section 4 above this 'sharing' can continue till April 2010 when the contribution for both the employee and employer must increase to 3%. Looking at the net cost figures in the table above, the cost of such an arrangement is less than would otherwise be the case because of the employer tax credit.

The benefits that can be delivered to employees are high, as noted in section 5.

Employers with an existing scheme - We see the issues for such employers as follows:

- KiwiSaver is here to stay, therefore any changes need to take account of this and determine what supplementary role other employer superannuation arrangements are going to play.
- The KiwiSaver employer costs can be reduced by accessing the employer tax credit.
- The KiwiSaver tax benefits are valuable to the employee.
- The employer may want to continue providing more than the average employer in regard to superannuation. It was doing so before KiwiSaver and that provision will have been built on a remuneration philosophy which the employer may well want to continue in future. The cost position now needs to be reviewed and considered.
- The future superannuation benefit design needs to allow for a continuation of benefits to existing members and a provision for the 'right' benefits to new employees.
- The issue of eligibility to the existing scheme needs to be looked at - should the scheme be available or be closed to new members.

Defined contribution schemes - The following are the issues we have identified:

- The option to establish a Complying Fund section within the existing scheme. Future changes to KiwiSaver are likely to result in costly amendments for complying funds. As a result, only larger schemes are likely to consider this option.
- The salary definition for contributions to KiwiSaver and to the existing scheme will be different in many cases, given the expanded salary definition that applies for KiwiSaver. It will be administratively difficult to continue using two salary bases, so that the practicality of moving the KiwiSaver salary definition into the existing scheme needs to be assessed.
- With few exceptions, employer contributions to the existing scheme will exceed the 4% KiwiSaver level. Many schemes have a 5% employer contribution and once the salary definition is resolved the dollar differences may not be significant. Thus for new members, the best option could be to change from a 5% (lesser salary definition) contribution level to a 4% (enhanced salary definition) contribution. Alternatively, with the value of the employer tax credits reducing the net costs to the employer, the employer could consider simply contributing at the higher contribution rate.
- Employers need to consider whether they will give existing employees the option to decide if they want to direct some or all of their future contributions to a KiwiSaver scheme. From a tax perspective, the optimal position for an employer is to direct the first 4% of both member and employer contributions to a KiwiSaver scheme. Some employees will welcome this option.
- A negative feature of KiwiSaver for some employers is that the benefits are generally only available from age 65. As such, KiwiSaver cannot be used to facilitate early retirement for employees.
- The existing vesting provisions need to be reviewed to ensure that they deal with the double dipping issue.
- For those with a master trust provided scheme, the logistics of integrating the existing benefits with the required contributions to the KiwiSaver scheme could cause difficulties.
- For employees starting employment after 1 April 2008, the existing scheme needs to state clearly that where the employee contributes to a KiwiSaver scheme, the employer's contributions to the existing scheme will be adjusted to allow for the employer's KiwiSaver contributions.

For an employer with a small defined contribution scheme, the question of whether to wind up the scheme or transfer the scheme to a master trust also has to be evaluated.

Defined benefit schemes - The following are the issues we have identified:

- The employer needs to consider whether the scheme should be restructured to allow the KiwiSaver tax advantages to be captured. However, while this is possible in theory, there are many practical difficulties to consider. As a result, we expect many defined benefit schemes to continue unchanged, with employees being free to join KiwiSaver and capture the tax benefits for just their personal contributions.
- Schemes which are currently open to new members will need to consider whether to close the scheme to new members in order to avoid 'double dipping'.
- Most defined benefit schemes are hybrid schemes, which will look to restructure their benefits as noted above in regard to defined contribution schemes.
- The trustees and the sponsoring employer will have already considered whether or not to continue the scheme and will have established good reasons to continue. These reasons need to be reviewed.
- In some cases the question of whether to offer pensioners the opportunity to cash up their existing pensions should also be reviewed.

8. Investment issues

The last year has seen many schemes revise their benchmark asset allocations to take full account of the new risk return outcomes for certain investment classes. The major impact has been on Australasian and global shares.

There has also been the issue of whether to tax the global bonds under the FDR regime or under the financial arrangements regime.

A further matter for consideration is that Trustees are required by the new legislation to address their stance on 'responsible investing'.

One outcome is that some KiwiSaver schemes will now move to include 'ethical' funds in the investment options that are made available.

9. KiwiSaver Seminars

Peter Fleming has recently joined Melville Jessup Weaver to provide independent Retirement Planning workshops and KiwiSaver seminars for employers.

Peter has worked in the superannuation industry for some 40 years and has developed a training programme that is specifically designed for employees contemplating retirement.

The interactive and comprehensive workshop covers the wide range of issues that prospective retirees need to plan for well in advance of their retirement, including sessions on how KiwiSaver works, with commentary on the KiwiSaver design features that make active membership worthwhile.

10. Looking forward

There is some talk of the current KiwiSaver scheme being revised further in the 2008 Budget. This would be in order to encourage employees to make further contributions and would be instead of higher personal tax cuts.

11. Further information

The IRD released a paper on 21 December 2007 on the new KiwiSaver legislation. The paper is available on: http://www.taxpolicy.ird.govt.nz/publications/files/KiwiSaverSR.pdf

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Appendix A: Double dipping rules

Defined contribution schemes:

Employer contributions to a defined contribution scheme can count towards the compulsory KiwiSaver employer contribution if:

- the scheme was registered before 17 May 2007 – or the contributions are paid to a successor scheme to which the employee has transferred under the compulsory transfer out provisions of section 9BAA of the Superannuation Schemes Act 1989 and the successor scheme was in existence as at 17 May 2007,
- the employer provided access for employees generally to the scheme before 17 May 2007,
- the employee was either in employment before 1 April 2008 or is employed under a collective agreement negotiated before 17 May 2007, and
- the contribution vests within five years.

Defined benefit schemes:

Employers are not required to make any compulsory employer KiwiSaver contribution to a defined benefit scheme if the following conditions are met:

- the scheme was registered before 17 May 2007 (or is a successor scheme),
- the employer provided access for employees generally to the scheme before 17 May 2007,
- the employee is either employed by the employer before 1 April 2008 or is covered under a collective agreement negotiated before 17 May 2007 or has had contributions paid to the scheme by a previous employer,
- the contributions being paid to, or credited within, the scheme are being made in respect of a retirement benefit that is calculated by reference to the employee's salary or wages, and
- the employer is required to make the contribution to the scheme either by statute, the scheme's trust deed, or under an employment contract.

Appendix B: Key features of the KiwiSaver Scheme

These are

- an employee member must contribute either 4% or 8% of their pre-tax salary or wages,
- funds are locked in until the age of eligibility for New Zealand Superannuation, or five years after the first contribution, whichever is later. There are exceptions for first home ownership, financial hardship, or permanent emigration,
- there is an upfront Government contribution of $1,000,
- a member may withdraw funds (excluding the Government $1,000 contribution) for the purchase of a first home if the member has been contributing to a scheme for at least three years. The Government will supplement the withdrawal amount by $1,000 per annum contribution up to a maximum of $5,000,
- fee levels are reviewed by the Government Actuary to confirm they are "reasonable",
- funds can be transferred between KiwiSaver providers,
- members will be able to apply for contribution holidays after an initial year of contributions, and
- a mortgage diversion scheme is available, enabling contributions to be used to meet mortgage payments.

KiwiSaver products and providers will be regulated consistent with other superannuation schemes and the Superannuation Schemes Act 1989 framework will apply.

Appendix C: KiwiSaver providers

Provider	URL	Phone Number
AMP	www.amp.co.nz	0800 AMP KIWI (0800 267 5494)
ANZ Bank	www.anz.co.nz	0800 500 648
Aon New Zealand Ltd	www.aonsaver.co.nz	0800 266 463
ASB Group Investments Ltd	www.asb.co.nz	0800 ASB RETIRE (0800 272 738)
Asteron Life Ltd	www.asteronkiwisaver.co.nz	0800 556 065
AXA New Zealand	www.axakiwisaver.co.nz	0800 292 728
Brook Asset Management Limited	www.brook.co.nz	0800 802 766
Civic Assurance	www.supereasy.co.nz	04 978 1250
Craigs Investment Partners Limited	www.craigsip.com	0800 878 278
Fidelity Life	www.fidelitylife.co.nz	0800 882 288
First NZ Capital Investment Management	www.firstnzcapital.co.nz	0800 421 114
Fisher Funds Management Ltd	www.fisherfunds.co.nz	0800 FF KIWI (0800 335 494)
Forsyth Barr	www.forbar.co.nz	0800 FORBAR (0800 367 227)
Gareth Morgan KiwiSaver Limited	www.gmk.co.nz	0800 GMK 015 (0800 465 015)
Grosvenor Financial Services	www.nzkiwisaver.co.nz	0800 336 338
Huljich Wealth Management	www.huljich.co.nz	0800 20 40 60
ING (NZ) Ltd	www.ingnz.com	0800 737 575
Legal & Professional Investment	www.lawretirement.co.nz	0800 445 586
Medical Assurance Society NZ Limited	www.medicals.co.nz	0800 800 MAS (0800 800 627)
Mercer (NZ) Limited	www.mercerwealthsolutions.co.nz	0508 MERCER (0508 637 237)
Mutual Superannuation Fund Limited	www.msf.co.nz	09 379 8052
National Bank	www.nationalbank.co.nz	0800 156 020
New Zealand Harbours Superannuation Plan	www.harbourssuper.org.nz	04 4990277
NZ Assoc. of Credit Unions	www.cukiwisaver.co.nz	0800 CU KIWISAVER (0800285494)
NZ Anglican Church Pension Board	www.koinoniafund.org.nz	0508 RETIRE (0508 738 473)
Professionals Group Holdings	www.psbg.co.nz	04 8194000
Real Property KiwiSaver Limited	www.rpks.co.nz	0800 546 980
SBS Bank	www.sbs.net.nz	0800 502 442
Smartshares Limited	www.smartshares.co.nz	0800 808 780
Staples Rodway	www.staplesrodway.com	0800 446 499
SuperLife Ltd	www.superlifekiwisaver.co.nz	0800 278 737
TOWER	www.towerkiwiplan.co.nz	0800 4TOWER (0800 486 937)
Westpac	www.westpac.co.nz	0508 WPAC KIWI (0508 972 254)

Source: https://www1.kiwisaver.govt.nz/interact/services/kiwisaver/locateprovider