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KiwiSaver Surprises in Budget 2007

The 2007 Budget announcements last week include some significant policy changes to the KiwiSaver scheme, the most controversial being the introduction of compulsory employer contributions from 1 April 2008.

This update begins with an overview of the KiwiSaver scheme, and then reviews the key changes announced in the 2007 Budget.

Overview of KiwiSaver

Enrolment

KiwiSaver is a voluntary scheme. However, most employees who begin new employment after 1 July 2007 will be automatically enrolled. When this occurs, the employee will only be able to "opt out" of KiwiSaver between days 13 and 55 after commencing their new employment. Employees opt out by notifying their employer or advising Inland Revenue.

Other employees, or people who are self-employed, can choose to enrol in KiwiSaver at any time, after 1 July 2007.

Once a person is enrolled in KiwiSaver, whether automatically or by choosing to opt-in, the KiwiSaver scheme applies to all of their future employment. There is no further opportunity to opt out of KiwiSaver once a person is enrolled.

Contributions

Employees who are enrolled in KiwiSaver are required to contribute either 4% or 8% of their gross salary or wages to their KiwiSaver account. The default rate is 4%, so contributions will be made at that rate if the employee does not make an election.

For the purpose of KiwiSaver contributions, "salary or wages" is defined widely and includes bonuses, commission, extra salary, gratuity, overtime or other remuneration of any kind.

Employees are able to stop contributing to KiwiSaver after the initial 12 months has passed by applying for a "contributions holiday". A holiday is only allowed after the first 12 months (unless the employee suffers from significant financial hardship). A contributions holiday can last for between three months and five years. Contributions will resume after the holiday, although the employee can also apply for a further holiday and there is no restriction on running back to back contributions holidays.

An employee cannot withdraw their savings from a KiwiSaver scheme until they are eligible for New Zealand Superannuation (currently age 65) or after they have been in the scheme for five years, whichever is the longer period. However, in certain circumstances such as significant financial hardship, serious illness or permanent emigration, or to purchase a first home, employees may be able to withdraw their contributions earlier.

Major points in Budget 2007

- Compulsory employer matching contributions to KiwiSaver to be phased in
- Employer tax credit of up to \$20 per week for employers making compulsory matching contributions
- Employee tax credit of up to \$20 per week for employee contributors

Benefits of KiwiSaver

To kick-start the scheme, the Government is paying a lump sum \$1,000 contribution into KiwiSaver accounts and also providing a subsidy of \$40 per year towards scheme fees. The kick-start contribution cannot be withdrawn to make a house deposit or in cases of significant financial hardship, but the \$1,000 otherwise forms part of the employee's KiwiSaver scheme savings.

Employer contributions to KiwiSaver schemes will be exempt from the tax that currently applies to employer contributions to superannuation schemes. This is subject to a cap of the lesser of the employee's own contribution or 4% of the employee's gross salary or wages.

A first home deposit subsidy of up to \$5,000 will be available to some people. To be eligible for this subsidy, the employee must have been saving through a KiwiSaver scheme for at least three years, and their income and the house price must be below set caps. KiwiSaver members may also be able to put part of their KiwiSaver savings, plus interest, towards the price of their new home. After being enrolled in the scheme for one year, a KiwiSaver member may also be able to divert half of their subsequent KiwiSaver contributions (but not any employer contributions) towards their mortgage.

Tax credits and compulsory employer contributions are two new benefits for KiwiSaver members that were announced in the 2007 Budget (discussed below).

KiwiSaver Schemes

Whilst KiwiSaver is a Government initiative, contributions will be invested in private sector schemes. People enrolled in KiwiSaver can select which KiwiSaver scheme they wish to belong to. This could be a scheme of their choice or a preferred scheme chosen by their employer. Where an employee (or their employer) does not choose a scheme, the employee will be allocated to one of six default scheme providers.

An employer that already has a superannuation scheme operating could consider converting that scheme to be a KiwiSaver scheme, or could apply to be "exempt" so that new employees are not automatically enrolled in KiwiSaver. There are strict conditions that must be met for exemption to apply, including a minimum 4% contribution and the same funds lock-in rules as KiwiSaver schemes.

The role of employers

KiwiSaver is a work-based savings plan, so employers will play an important role.

From an administrative point of view, employers are required to give new employees, and others who are interested, a KiwiSaver information pack (provided by Inland Revenue). Employers pass on employees' details to Inland Revenue to enable them to be enrolled, and deduct KiwiSaver contributions - while the contribution of 4% or 8% to KiwiSaver is calculated from the gross salary figure, tax is still payable on the employees' entire gross salary. Employers will also hand out investment statements for their preferred KiwiSaver provider, if they have one.

Employers will also need to be ready to provide information to employees about how KiwiSaver will operate, particularly for new employees who will be automatically enrolled. Employers should not provide financial advice to employees but instead refer them to a financial adviser or the Government website - www.sorted.org.nz. The major new impact on employers will be the compulsory employer contribution announced in the 2007 Budget (outlined below).

Key Changes announced in the 2007 Budget

The first nine months

From 1 July 2007 to 31 March 2008, employers will be free to choose whether or not to make contributions to KiwiSaver schemes that their employees belong to. If an employer does make a contribution to a KiwiSaver scheme, it must be paid via Inland Revenue and not directly to a scheme provider.

In this first 9-month period, any employer contributions are voluntary and can count towards the minimum 4% contribution that is required from employees who participate in KiwiSaver. For example, an employee can contribute 2% and the employer 2%, to comprise the minimum 4% employee contribution that is required. However, from 1 April 2008, employer contributions will no longer count towards the minimum 4% employee contribution (except that there will be transitional rules for employees who join KiwiSaver before 1 April 2008 and contribute less than 4% at the start).

Compulsory employer contributions

The Government has announced that from 1 April 2008 employers will be required to make compulsory employer contributions to KiwiSaver for employee members. The employer contribution is only for those employees who are enrolled in KiwiSaver and actually making contributions.

The rate of compulsory employer contributions will begin at 1% of the employee's gross salary or wages and will be phased in over 4 years to eventually match the employees' minimum 4% contribution rate as follows:

- From 1 April 2008 – 1%
- From 1 April 2009 – 2%
- From 1 April 2010 – 3%
- From 1 April 2011 – 4%

So from 1 April 2011, an employer must match 4% of an employee's gross salary or wages as a KiwiSaver contribution where that employee is also a contributing member of KiwiSaver. However, employers will not be required to match employee contributions that are higher than the minimum 4% level.

As noted above, the definition of "gross salary or wages" is very wide, and includes bonuses, commission, overtime, extra salary, gratuity or other remuneration of any kind.

Tax credits

The new Inland Revenue fact sheet for employers states that the Government will "reimburse" employers for their compulsory contributions to KiwiSaver by providing a matching tax credit of up to \$20 per week (\$1,040 per year). This will begin on 1 April 2008.

While it is not yet clear how this will work in practice, Inland Revenue advises that the employer tax credits will be paid through the PAYE system by offsetting the credit against the employer's contribution and other PAYE liabilities.

The employer tax credit of \$20 per week is the maximum "reimbursement" available for any particular employee; regardless of whether the compulsory employer contribution to KiwiSaver is higher than the available tax credit. As an example, 4% of a \$30,000 gross salary equals \$1,200 per year, which is more than the maximum tax credit currently provides.

"Gross salary or wages" includes:

- bonuses
 - commission
 - overtime
 - extra salary
 - gratuity
- or other remuneration of any kind

Employer contributions will be exempt from tax, subject to a cap of the employee's contribution or 4% of their gross salary or wages.

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This newsletter has been prepared by Minter Ellison Rudd Watts. Professional advice should be sought before applying the information to particular circumstances.

The 2007 Budget also provided for a reduction in the company tax rate of 3% (from 33% to 30%) and it has been suggested that this is in part to assist employers meet their new KiwiSaver contribution obligations.

From 1 July 2007 employees will also receive a form of tax credit that matches their contributions to KiwiSaver up to a maximum of \$20 per week (up to \$1,040 per year). These tax credits will be paid directly into the employee's KiwiSaver account and cannot be withdrawn by the employee to make a deposit on a first home or used for mortgage diversion. Self employed people will also qualify.

Implications for employers

The surprise introduction of mandatory employer contributions to KiwiSaver, increasing to a maximum of 4% of gross salary or wages, was not the subject of prior consultation or debate with the business and employer communities. It would be fair to say that most employers would prefer to have a choice about whether to contribute to their employees' KiwiSaver accounts or not.

In the absence of this choice, this significant change to the KiwiSaver scheme is a factor which employers will need take into account in wage negotiations as there will be an unavoidable added cost to their bottom line. However, it will be difficult for employers to predict, with any certainty, what the actual cost will be from year to year as it will depend on how many new and existing employees join KiwiSaver and how much those employees are paid in salary or wages.

As noted above, employer contributions to KiwiSaver schemes will be exempt from tax, subject to a cap of the lesser of the employee's contribution or 4% of the employee's gross salary or wages.

The tax credit for employers and the reduction in the company tax rate, though welcome, will likely fall short of compensating most employers for the additional cost of KiwiSaver into the future.

This makes it more important than ever for employers to have a clear understanding of the KiwiSaver scheme and how it will impact on their organisation.

How we can help

We expect that many employers will have questions about how the employer contribution scheme will operate, particularly where employees receive remuneration in the form of commission or bonuses or where bargaining for wage increases is pending or already underway. There are also practical issues to consider where there is already a company superannuation scheme in operation.

Also, the Government has stated that employers and other interested parties will have the opportunity to comment on the changes relating to compulsory employer contributions and the employer tax credit through the Select Committee consultation process in the coming months. Together with our Public Law and Tax teams, we are experienced in making the most of that process for our clients, and would be happy to talk to you about this.

If you have any questions about how the changes to KiwiSaver will impact on your organisation, please do not hesitate to contact us for assistance.