Tax Treatment of Superannuation

Report of the Consultative Committee

July 1988

26 July 1988

STATEMENT BY

Minister of Finance, Hon R O Douglas

RELEASE OF THE REPORT ON SUPERANNUATION

The Government is pleased to release this report on the taxation of superannuation prepared by the Consultative Committee on Superannuation, Life Insurance and Related Areas. The report comprehensively covers a number of complex issues relating to the taxation of retirement savings. It is a valuable contribution to taxation reform, justifying the Government's commitment to reform with consultation.

Our decisions on the Committee's detailed, technical recommendations are noted in the report. This covering statement highlights and explains our decisions on the report's key recommendations and on the other issues raised.

Response to the Report

The report endorses the thrust of the Government's taxation reform programme and the place of the superannuation taxation proposals in that programme. Most of the Committee's specific recommendations are agreed to.

As the Committee notes, the superannuation measures are part of and must be advanced consistently with the Government's wider tax reform programme. This includes the proposals contained in the final report of the Consultative Committee on Full Imputation and International Tax Reform. In particular, the full imputation and international report recommends a major reform of trust taxation. This recommendation has been agreed to.

The Superannuation Committee formed its views without the benefit of full knowledge of those other proposed tax changes. We have considered the reports of both Committees and ensured that the recommendations accepted are consistent. This has influenced our conclusions on some aspects of the Superannuation Committee's report. For example, we have as a result not advanced the Committee's suggestion that a modified taxation regime for superannuation be explored further.

Superannuation as Part of Wider Tax Reforms

On 17 December 1987, the Government announced proposed changes to the way in which superannuation scheme savings are to be taxed. Essentially this involved removing the tax privileges which superannuation enjoyed relative to other forms of saving and investment. This was advanced as part of the Government's general tax reform programme of lowering tax rates and removing the artificial distinctions, penalties and privileges which had undermined the New Zealand tax system and the performance of the economy generally. As this programme continues, we are moving from a system with high taxes which the rich avoid, to a system with lower tax rates which everyone pays. The need to include superannuation in this overall review of the tax system was signalled in the 1984 Budget.

More particularly, the superannuation proposals were part of, and indeed made possible, other taxation reforms such as the restructuring of the personal tax scale with, in general, lower and less variable tax rates. In conjunction with the dividend imputation system, details of which were also announced in December, the proposed superannuation measures will move us towards a more consistent tax treatment of different forms of investment and saving.

Value of the Consultative Process

To the extent to which it is possible and practical, the Government has sought public input into the tax reform process by way of the consultation process. In accordance with this policy, a Consultative Document on Superannuation was released in March and a committee of private sector experts appointed to consider the proposals and public submissions on them. The potential for abuse of the tax concessions once reform had been signalled made it necessary to enact some of the new measures at an early stage. These measures were kept to a minimum.

It was always recognised that the timetable for consultations was tight. However, extending that timetable would also extend a period of uncertainty for the superannuation industry. A lengthy consultative period would therefore have been counter-productive.

Committee's Terms of Reference

At an early stage in its deliberations, the Committee sought clarification that its terms of reference enabled it to consider and comment on policy aspects underlying the proposals. This was readily agreed to.

As a result, the Committee's report is a comprehensive review of the taxation of retirement savings. This is a valuable and considered analysis of complex issues. Committee members are to

be congratulated on their efforts and the quality of the report, especially given the time constraints which, of necessity, they had to work under.

Committee Supports a Non-Concessionay Tax Regime for Superannuation

The Committee, in its report, agrees that "there is no good basis for providing tax concessions to particular types of institutions" and goes on to endorse "the desirability of neutrality in tax matters" (page 10).

The reasons for removing superannuation tax privileges were set out in the Consultative Document. Briefly, these were that such privileges:

a are expensive in terms of tax revenue forgone and thus require everyone else to pay higher tax rates;

b are unfair in that they benefit the rich rather than those who may need Government assistance;

c are frequently abused so as to benefit the rich even further; and

d incur high economic costs by distorting investment behaviour and remuneration structures, and by requiring savings to be heavily regulated so as to reduce tax abuse.

The Committee was presented with the argument which has frequently been advanced in the media that superannuation tax privileges are in fact enjoyed on an equal basis by all income groups. The Committee considered this argument, but found it lacking. As stated in page four of the report:

> "High income earners typically save more in tax (because of their higher marginal tax rates) for any given level of superannuation exemption than do low income earners; high income earners are able to save a higher proportion of their income, and shelter the income on that savings through superannuation schemes, than can low income earners; and . . . it is the high income earners who receive overwhelmingly the largest part of the employer subsidies."

The Committee has expressed concern that the removal of superannuation tax concessions would, taken in isolation, "probably result in some reduction in aggregate savings" (page 17) although it considered claims of a large fall-off in savings to be "unduly alarmist". Furthermore, the Committee "acknowledges that there is much in the overall tax reform programme - dividend imputation, GST, and lower [personal] and

company tax rate[s] to mention the major items - which does reduce the rate of tax on savings." (page 10).

The tax reform programme, of which superannuation is a part, provides significantly increased incentives for effort and saving. This can only be good for the economy. Moreover, the Government's responsible approach to its own spending and budgetary position is ensuring that New Zealand is reversing the past tendency to spend, borrow and hope.

With respect to superannuation tax privileges in particular, the existence of those concessions has meant that in the past the industry has tended to sell superannuation as a tax break. There has been no need to sell superannuation and other forms of retirement savings on its intrinsic merits which are considerable. If the vast resources of this industry are redirected from selling tax concessions to educating the public about the need to save for retirement, a more secure pool of savings for investment and growth will result. This is already beginning to happen.

In addition, a more flexible and competitive superannuation industry should result from the reforms being put into place. This should lead to a better service being provided to savers who will have a greater ability to move their funds to the institutions best meeting their requirements. This will also improve the incentives to set aside savings for retirement or for other purposes.

The Government Superannuation Fund (GSF)

The Committee recommends that the GSF be reviewed to ensure that GSF members are not advantaged relative to their private sector counterparts. In discussing the changes that would need to be made to private sector schemes following the tax reform, the Committee suggests that:

> "it would be quite intolerable if the members of the GSF were insulated from changes of that kind simply by virtue of the Government's ability to 'write a cheque on the taxpayer'."

The Committee also expresses serious reservations about the desirability of continuing with the provision of fully inflation-adjusted pensions for members of the GSF. In particular, the Committee notes that "no private scheme can hope to offer benefits of comparable value", and recommends that this preferential treatment be withdrawn in the context of the renegotiation.

The Government agrees that the benefits available under the GSF scheme should be renegotiated on the same basis as the benefits of private sector schemes. The issue of inflation adjustment is one of a number of issues that could be considered in the course

of renegotiating GSF benefit levels.

National Superannuation and a Modified Non-Concessionary Tax Regime for Superannuation

The Committee has recommended immediate implementation of the taxation regime for superannuation proposed in the Consultative Document with some detailed changes. It has also recommended that consideration be given to a modified non-concessionary regime in the future for pension schemes which would involve deductibility or tax-exemption of contributions to such schemes but would put an offsetting tax on pensions.

A central policy concern of the Committee's report is the desirability of a stable government policy framework in which people can plan and save for retirement. In this regard, the Committee has noted the frequent changes to the taxation regime applying to superannuation funds. It also notes similar changes to state retirement income support measures.

The Committee argues that further changes to national superannuation will be necessary because the costs of the present system are, in the Committee's view, unsustainable. The Committee expresses "serious reservations" as to whether the current costs of national superannuation are "acceptable", and states that it "has not seen any serious argument that the cost is sustainable over the next 30 to 40 years." (page 12)

The Committee thus supports a less generous form of state retirement income support with greater reliance on private provision. It identifies three obstacles to achieving a cut in the cost of national superannuation:

a the political power of those entitled to the benefits;

b the belief, erroneous in the Committee's view, that current beneficiaries are entitled to current benefit levels. It is argued that "it is simply untrue to suggest that those drawing National Superannuation have paid for it" (page 12); and

c an income-tested national superannuation scheme "produces a situation where, for many income-earners, there is little if any incentive to save for retirement."

In order to be able to reduce the costs of national superannuation, and to institute a stable policy environment for retirement, the Committee has recommended an urgent review of national superannuation on a bi-partisan basis with, in this context, consideration being given to a modified non-concessionary taxation regime for pension superannuation schemes.

The modified non-concessionary pension superannuation taxation regime suggested for consideration involves up-front deductions for superannuation contributions with an offsetting tax on 75% of superannuation benefits.

The Committee envisages that such a taxation regime would be implemented together with a revised and less generous national superannuation policy and identified the following advantages associated with it:

a a more stable income tax regime for superannuation on the basis that the Committee identified a strong public perception that the non-taxation of scheme benefits was not in accordance with normal income tax rules and that the Government would eventually tax such benefits. While the Committee sees this perception as irrational, the widely-held view that the Consultative Document's taxation regime was peculiar and unusual would discourage savings through superannuation;

b no taxation of employer contributions thus overcoming employer resistance to incurring an FBT liability;

c reduction in the disincentive to save for retirement currently imposed by the surcharge;

d removal of the tax incentive that could otherwise induce employers to internally fund employee retirement schemes to the detriment of the security of employee retirement income.

The Committee's views on national superannuation have been noted and will be borne in mind by the Government. The desirability of a bi-partisan approach is accepted and an offer to review national superannuation on a bi-partisan basis has previously been issued to the Opposition. The other issues raised by the Committee are valid and have received serious consideration.

The need for a stable taxation regime for superannuation is accepted to be imperative. For that reason also, an early decision on the Committee's recommendation to consider a modified taxation regime for pension schemes is necessary.

It is accepted that the taxation treatment of superannuation has in the past been subject to too many changes. It seems inevitable that as long as superannuation is subject to a taxation regime which is not normal, and accepted as such, that regime will frequently be changed. That is why superannuation schemes have been subject to more taxation changes than other savings entities.

There is therefore a concern if the Consultative Document's proposals are not accepted as normal and justifiable income tax treatment. As recommended by the Committee, and agreed to by the

Government, superannuation schemes will be required to be established as trusts (which means that the funds are held for the benefit of scheme members) and thus, in the absence of special provisions, they would be taxed as trusts. Therefore the most stable and justifiable taxation regime which schemes could have would be the normal tax treatment for trusts.

The Consultative Committee on Full Imputation and International Tax Reform has since made detailed recommendations proposing that the tax treatment of all trusts should be standardised and reformed. In broad terms, the recommended standard tax regime for trusts is: no deduction for settlements on, or contributions to, trusts; taxation of trust income at a single tax rate; and tax-free benefits, including benefits in income form. These recommendations have been agreed to, and this taxed/taxed/exempt regime will become the normal and standard income tax treatment of trusts.

These changes will mean that the Consultative Document's proposed taxation regime for superannuation can be implemented as consistent with, and as an extension of, normal trust income tax treatment. This should relieve the Committee's concerns that the proposed tax treatment of superannuation will be seen as abnormal and temporary.

The Committee was concerned that the Fringe Benefit Tax proposed to apply to employer contributions would discourage employer participation in superannuation schemes. To overcome this, the Committee recommends that the Fringe Benefit Tax be replaced by a final withholding tax on such contributions. The Government has accepted the Committee's recommendation.

The effect of the national superannuitant surcharge on the incentive to save for retirement is acknowledged. The Government has reserved its decision on the application of the surcharge to superannuation scheme pensions pending further consideration of the whole issue of the provision of retirement income support.

The Committee was also concerned that, if scheme earnings were taxed at a rate higher than the company rate, employers would be encouraged to run unfunded retirement income programmes for employees. The Government shares this concern. To overcome it, the 25% transitional tax rate will apply to most superannuation schemes until 1 April 1990. During that time, the question of the appropriate tax rate for fund earnings after 1 April 1990 will be reviewed. This should obviate this concern.

As the Committee's report notes, there are a number of disadvantages with their suggested modified non-concessionary taxation regime. These include the greater likelihood that current pension beneficiaries would receive a fall in after-tax income under such a regime, and greater concerns about tax avoidance opportunities. The latter would require restrictions on access to funds.

In view of the above points (especially the consistency which the original proposal would give to trust taxation in general), and the need for an early decision to enable superannuation funds to plan for the future, it has been decided not to proceed with further consideration of the modified taxation regime outlined in the Committee's report.

Summary of Detailed Recommendations on the Taxation of Superannuation

The TTE regime proposed in the Government's Consultative Document (CD), together with the Committee's recommendations for detailed changes to aspects of that regime, and the Government's decisions are as follows:

a Member Contributions: these will be made from the after-tax income of members. There will, therefore, be no personal exemption for member contributions to superannuation schemes.

b Employer Contributions: these will also be made from taxed income. The Committee recommends that the FBT on employer contributions proposed by the Government be replaced with a final witholding tax payable by employers. This recommendation is accepted.

c Scheme Earnings: under the TTE regime, scheme earnings are taxed.

d Scheme Benefits: both lump sum and pension benefits are to become tax-exempt.

e Tax Rates: the Committee proposes that a tax rate of 28% apply to both employer contributions and scheme earnings from the 1989/90 income year. The Committee accepted the logic of applying a 33% rate, but was concerned that use of a rate higher than the company tax rate would encourage employers to run unfunded schemes (ie defer paying employer contributions into the superannuation fund).

  After considering the Committee's arguments, the Government proposes that, until 31 March 1990, Class A lump sum schemes and pension schemes that existed on 17 December 1987 (previously tax-exempt schemes) be subject to tax on earnings at the transitional rate of 25%. Schemes that are currently taxed at 33% and new schemes will be taxed at 33% until 31 March 1990. During the transitional period, the rate of tax to apply to scheme earnings will be reviewed in the light of the Committee's concerns.

The Committee's concerns about unfunded schemes do not apply to the tax rate on employer contributions. This is because, while the 33% rate is avoided initially in an unfunded scheme, it would still be paid later when the sum which had accumulated outside the fund was paid into the fund or paid directly to employees. Further, use of the 28% rate proposed by the Committee would create unacceptable avoidance opportunities for higher income earners. Employer contributions to superannuation schemes will therefore be taxed at 33% from 1 April 1989.

f Treatment of capital gains of superannuation funds: the Committee considers that there should be no special provisions to include realised capital gains in the tax base of schemes. The treatment of capital gains would therefore be determined by existing law. This recommendation is accepted.

g Deductibility of non-investment expenses of super schemes: it is proposed that all expenses be deductible to the fund. The Government's decision on this recommendation has been deferred pending the Committee's second report which will cover the taxation of life offices (where the same issue arises).

h Application of national superannuitant surcharge to pensions: the Committee does not support the proposal to levy the surcharge on 50% of pension benefits. It considers that the surcharge is often readily avoided and that applying it to 50% of pensions would therefore discriminate against pensions.

The Government has reserved its decision on this matter pending a review of the whole issue of the provision of retirement income support.

i Avoidance: the Committee proposes two measures to prevent superannuation schemes being used for tax avoidance. The Government accepts the need for such measures and has agreed to the recommendations subject to some minor modification.

Regulatory Regime for Superannuation

The Committee has recommended that the Government Actuary be given a new prudential supervisory role in relation to superannuation schemes. In the view of the Committee, the existing regulatory and supervisory structure within which superannuation schemes operate is insufficient to guarantee the security of members' contributions. The Committee's recommendations for reform of the regulatory structure for superannuation schemes are more complex than current law and involve important additional powers for the Government Actuary.

The Government considers that a separate regulatory regime for superannuation with an extension of the powers of the Government Actuary may not be necessary. A simpler and more flexible regulatory regime may be more appropriate for superannuation schemes.

The Committee has also proposed constraints on access to scheme benefits. While these constraints would be necessary under an ETT regime such as that considered by the Committee, or where tax concessions apply, such constraints should not be necessary under the TTE regime proposed by the Government. Decisions on the regulatory regime for superannuation funds will be released as soon as possible.

Adjustment of Scheme Benefits

The Government and the Committee agree that the date for the completion of adjustment of scheme benefits should be extended to 31 March 1990 (from 1 July 1989). It is also agreed that all existing approved schemes should be given interim registration under the new legislation governing superannuation schemes until 31 March 1989.

The Committee has suggested that it is not practical for scheme trustees to gain the agreement of scheme members where benefits need to be adjusted following the tax changes. It has therefore proposed that scheme trustees, acting in the interests of the members, should set new benefit levels under the supervision of the Government Actuary.

The Government accepts this position. However, it remains desirable for trustees to renegotiate scheme benefits with members where this is feasible. In addition, to avoid any danger that the trustees may treat the elderly unfairly, I propose that the guidelines for adjustment of scheme benefits will stipulate that the Government Actuary's approval will be dependent upon the after-tax pensions of those New Zealand resident scheme members who are in or near retirement being maintained wherever possible.

Transitional Measures

The Committee has proposed that the transitional tax rate of 25% for the earnings of Category 1 schemes existing as at 17 December 1987 apply only for 1988/89. As noted in (e) above, the Government has decided that, to ease the transition from a highly subsidised to an unsubsidised regime for superannuation savings, this rate should remain until 31 March 1990. Further, as proposed in the Economic Statement of 17 December 1987, the requirement to pay provisional tax in 1988/89 will be waived for these schemes.

Removal of the Tax on Pensions

The Committee agrees with the Government's original proposal to remove the tax on pensions from 1 April 1989, and has argued that this should not be dependent on satisfactory adjustment of benefit levels. However, to avoid unnecessary fluctuations in the net incomes of pensioners, it is desirable that the tax be removed from pensions from the same date that new pension levels are set. Accordingly, the Government has decided to remove the tax on pensions from 1 April 1990 with schemes being required to obtain Government Actuary approval before paying adjusted pensions. This will also help to reduce the windfall gains which will accrue to many existing pensioners under this reform and which were a source of concern to the Committee. It is important to note that the funds being withdrawn from pension schemes in 1989/90 will have accumulated with the benefit of exemption from taxation under an Exempt/Exempt/Taxed regime. Retaining the tax on pensions for a further year does not, therefore, raise concerns about double taxation.

The Government intends to legislate for the removal of the tax from pensions from 1 April 1990 as soon as possible.

Roger Douglas

R O Douglas
Minister of Finance

Office of the

Consultative Committee on Superannuation, Life Insurance and Related Areas

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WELLINGTON

20 June 1988

Hon R.O. Douglas MP,
Minister of Finance,
Parliament Buildings,
Wellington.

Dear Mr Douglas,

I enclose the Consultative Committee's Report on the superannuation part of Volume 1 of the Consultative Document on Superannuation and Life Insurance, which you released in March 1988. This Report deals only with superannuation.

We have also prepared draft legislation, which we enclose as an Appendix to our Report. It will be necessary to consider details and consequential changes in relation to the draft.

The Committee believes that the Government should give serious consideration to the adoption of what we call a modified exempt/taxed/taxed regime for pension schemes, in preference to the orthodox taxed/taxed/exempt approach recommended by the Consultative Document. Strictly speaking, our recommended E/T/T approach is outside the terms of reference. In these circumstances, we have prepared our Report to cover both approaches.

The Report has four main Chapters. It then contains five separate appendices, each of which deals with the details. This format will enable you to reach a decision about which regime you prefer, and provides considerable detail in relation to how that particular regime operates.

We have appreciated the assistance and advice of Allan Archer, Government Actuary, Ross Judge and Kathy Spencer of Treasury, and Greg Frontin-Rollet of the Inland Revenue Department in the preparation of the Report, and Robbie Cullen of Rudd Watts & Stone for his assistance with the draft legislation.

Yours sincerely,

Donald T. Brash
Chairman

TABLE OF CONTENTS

Letter to the Minister of Finance

Table of Contents		Page
Chapter 1 - Introduction and Summary		1
1.1	Announcement of Government Policy and Formation of Consultative Committee	1
1.2	Submissions Received	2
1.3	The Criticisms Summarised	3
A.	Lack of consultation	3
B.	Retrospectivity	3-4
C.	Distribution of Benefits	4-5
D.	Lack of neutrality	5
E.	Security of private retirement plans	5
F.	Effect of proposals on level of savings	5-6
G.	Need for long term stability	7-8
1.4	Brief Summary of Key Recommendations	9
Chapter 2 - A Concessionary Tax Regime?		9
2.1	The Arguments Against a Concessionary Tax Regime	9
2.2	Reaction of the Consultative Committee to the Case for Providing No Tax Privileges for Saving	9-10
2.3	Effect of State Provision of Retirement Income	10-11
2.4	Prospects for National Superannuation	11-12
2.5	The Political Problem in Changing National Superannuation	12-13
2.6	Possible Options	13
2.7	The Special Problem of the Government Superannuation Fund	14-15
2.8	Desirability of Bipartisan Approach	15-16

Chapter 3 - Non-Concessionary Options 17

3.1 Taxed/Taxed/Exempt - T/T/E 17-19

3.2 Exempt/Taxed/Taxed - E/T/T 19-20

3.3 Disadvantages of an Exempt/Taxed/Taxed Regime 21-23

3.4 A Possible Compromise 23-26

Chapter 4 - Main Conclusions 27

4.1 Key Features of the taxed/taxed/exempt regime 27

4.1.1 Deductibility of Contributions 27-28
4.1.2 Shareholder Employees 28
4.1.3 Taxation of the Income of Superannuation Schemes 28-30
4.1.4 Tax Rates 30-31
4.1.5 Application of the National Superannuation Surcharge 31
4.1.6 Relationship between a T/T/E Regime and State Targeted Support Measures 32
4.1.7 The Importance of Reducing Overall Tax Rates, and Harmonising Personal and Company Rates 32-33

4.2 Key Features of the exempt/taxed/taxed regime 33

4.2.1 Proposed Limit on Deductibility of Contributions 33-35
4.2.2 Tax on Fund Income in an E/T/T Regime 35
4.2.3 The Taxation of Benefits from RIFs 35-36
4.2.4 Transition to Modified E/T/T Regime 36-37

4.3 Re-negotiation of Superannuation Schemes 37-38

4.4. Registration and Regulation 38-39

APPENDICES

APPENDIX 1 - TAXATION UNDER T/T/E

A1.1 Introduction 40
A1.2 Definition of Superannuation 40-42
A1.3 Member Contributions 42-43
A1.4 Employer Contributions 43-51
A1.5 Shareholder - employees 51-53
A1.6 Superannuation Fund Net Investment Income 53-62
A1.7 Tax Rates 62-66
A1.8 The Taxation of Benefits 66-71
A1.9 Relationship between a T/T/E Regime and State Targeted Income Support Measures 71-74

A1.10 Miscellaneous Considerations 74-76
A1.11 Non-registered and Non-resident Schemes 76-78

Schedule 1.1 Tax Rate Scale 79-83

APPENDIX 2 - TAXATION UNDER E/T/T

A2.1 Introduction 84-85
A2.2 Definition of Superannuation 85
A2.3 Member Contributions and Employer Contributions 85-88
A2.4 Shareholder Employees 88
A2.5 Superannuation Fund Net Investment Income 88-89
A2.6 Tax Rates 89
A2.7 Benefits and the Taxation of Benefits from a RIF 89-93
A2.8 Amendments to Income Tax Act to introduce modified E/T/T 93-96
A2.9 Relationship between E/T/T Regime and State Targeted Income Support Measures 96
A2.10 Miscellaneous Considerations 96-97
A2.11 Summary of Recommendations 97-98

APPENDIX 3 - RE-NEGOTIATION OF SUPERANNUATION SCHEMES

A3.1 The Need for Renegotiation for Benefits and Contributions 99
A3.2 The CD's Re-negotiation Approach 99
A3.3 Comment 99
A3.4 The CD's "Equitable Basis" Approach 100
A3.5 Discussion 100
A3.5.1 Defined Contribution Schemes 100
A3.5.2 Defined Benefit Schemes 100
A3.5.3 Options 101
A3.5.4 Discussions of Options 1 and 2 101-102
A3.6 Discussion of Actuarial Basis used in revision of Defined Benefit Schemes 102-103
A3.7 Summary of Recommendations 103-104

APPENDIX 4 - THE REGULATORY REGIME FOR T/T/E AND E/T/T

A4.1 Introduction 105-106
A4.2 Present Regulatory System 107-108
A4.3 Summary of Features of Proposed Regulatory Regime 108
A4.4 Special Role of Member Trustee 108-109
A4.5 Role of Government Actuary 109
A4.6 Prudential Supervision by the Government Actuary 109-112
A4.7 Role of the Auditor 112-113
A4.8 Role of Trustees Reports to Members 113
A4.9 Role of the Trust Deed 114-115
A4.10 Role of Solicitors and Actuaries in Scheme Design 115-116
A4.11 Limit on Investments of RIF and RLSF Funds 116-117

A4.12	RIFs and other Investment Funds	117
A4.13	Non Employer related RIFs	117
A4.14	Transition Issue whether there should be a requirement for existing schemes to convert to the proposed new rules	118
A4.15	Amendment to other Non Tax Legislation	118-119
A4.16	Accounting Standards	119
A4.17	Summary of Recommendations	119

APPENDIX 5 - DRAFT RETIREMENT FUNDS ACT AND EXPLANATORY NOTE

A5.1	Explanatory Note for Draft Retirement Funds Act	120-129
A5.2	Draft Retirement Funds Act	129-163
	- Index to the Retirement Funds Act	
	- The Retirement Funds Act	
	- First Schedule to Retirement Funds Act	
	- Index to Second Schedule to Retirement Funds Act	
	- Second Schedule to Retirement Funds Act	
	- Third Schedule to Retirement Funds Act	

REPORT OF THE CONSULTATIVE COMMITTEE ON SUPERANNUATION TO THE MINISTER OF FINANCE

CHAPTER 1 - INTRODUCTION AND SUMMARY

1.1 Announcement of Government Policy and Formation of Consultative Committee

On 17 December 1987, the Government announced a series of far reaching economic policy changes, one of which related to the tax treatment of superannuation. The 17 December statement was further amplified by a ministerial statement on 10 February 1988, and at that point most of the features of the proposed treatment of superannuation were outlined. Essentially, the Government proposed to ensure that contributions to superannuation schemes would henceforth be from tax-paid income, and that the income generated within such schemes would be taxed at a rate approximating the marginal rate of contributors, while on the other hand providing that all benefits paid out by superannuation schemes would be exempt from taxation.

Early in March 1988, the Government issued the "Consultative Document on Superannuation and Life Insurance: Volume 1", setting out the proposed changes in detail. The Consultative Document was critical of the previous tax regime as it applied to superannuation, and noted that under that regime savings channelled into superannuation received a markedly more concessionary tax treatment than savings channelled into other areas, such as banks.

Section 5.1 of the Consultative Document argued that past tax concessions provided to superannuation have "been expensive in terms of tax revenue lost, created distortions in investment patterns and in employment behaviour, created the need for tight regulatory control of superannuation funds, led to tax planning, and have made the tax system unfair by favouring the high over the low income earner. Arguments for retaining tax preferences - the desirability of encouraging savings and the desirability of encouraging private, as opposed to public, provision for retirement - do not, in the end, stand up to close analysis".

Following a pattern adopted on several previous occasions, the Government invited public submissions "on matters concerning the implementation and operation of the measures proposed" in the Consultative Document, and established a Consultative Committee to receive those submissions. The Committee was charged with reporting to the Minister of Finance on matters raised in the submissions concerning "the implementation and administration" of the proposed changes, as well as to suggest possible amendments to the detailed changes set out in the document "consistent with the Government's policy announcements and policy objectives".

1.2 Submissions Received

In response to that invitation, a total of 225 submissions were received:

Employers and employer-related superannuation schemes	72
Private individuals	88
Superannuation professionals (actuaries, life insurance companies, fund managers, etc)	33
Trade and professional associations, accountants, trade unions, and other	32
Total	225

Of the submissions from private individuals, 46 took the form of two or three essentially standard letters, obviously reflecting an organised lobbying campaign in some areas.

It was not possible to meet personally with most of the parties who had made submissions. But we were able to meet with the following:

AMP Society
Association of Consulting Actuaries of New Zealand
Association of Superannuation Funds of New Zealand
Government Life
Life Offices' Association
National Mutual
National Provident Fund
New Zealand Council of Trade Unions
New Zealand Society of Actuaries

In comparison to the 1067 written submissions made to the Advisory Panel on the Goods and Services Tax, and the 1084 submissions made to the Consultative Committee on Primary Sector Taxation, the 225 submissions made on the proposed changes to superannuation taxation seem modest in number, particularly in the light of the number of form letters. On the other hand, the submissions on superannuation frequently argued on behalf of many hundreds, indeed sometimes many thousands, of superannuation scheme members, and were reflective of a very widespread public interest in the Government's proposals.

As noted above, the Government charged us with the responsibility of receiving public submissions, and reporting to the Minister of Finance, on matters concerning "the implementation and administration" of the proposed changes. Our terms of reference did not, therefore, extend to a comprehensive analysis of the merits or demerits of the Government's proposals.

We would be failing in our duty, however, if we did not report to the Minister that the overwhelming majority of submissions received were very strongly opposed to the policy which Government has announced in this area. In a few cases, the anger was directed at the Committee itself, in the mistaken belief that the Committee had initiated the policy proposals.

1.3 The Criticisms Summarised

There were seven major areas of concern mentioned frequently:

A. Lack of consultation - Many of those professionally involved in providing superannuation services recalled frequent Government promises of "consultation" with the industry before any major changes were announced. Those parties resented Government's policy announcements as a fait accompli. Two submissions actually called upon the Committee to resign immediately, on the grounds that the whole consultation process was a farce, particularly in view of the fact that several of the key features of the proposal had already been enacted into legislation.

B. Retrospectivity - A number of submissions expressed concern that the proposals would effectively abrogate existing contractual rights, and give little or no time to adjust financial plans. Several submissions described the proposals as having retrospective effect, and argued that the existing tax treatment should apply to all superannuation schemes, or at least all existing members of existing schemes, as at 17 December 1987.

The Committee recognises that this is a very difficult area. If it is accepted that the present multiplicity of tax regimes applying to different superannuation schemes is undesirable, and that the present situation is both open to manipulation for tax planning purposes and inefficient as a means of providing retirement income to the majority of the population, as many submissions did, then it follows that some fundamental change is required. It also follows that, unless arrangements existing at 17 December 1987 are to be preserved until the death of those concerned, in perhaps 50-60 years' time, some element of "retrospectivity" is inevitably involved in that change. It was for this reason that the Consultative Document proposed concessionary arrangements to smooth the transition from the previous regime to the proposed one.

The Committee believes that it would be quite unreasonable to expect any Government to tie its hands for a period of up to 50 or 60 years. This is particularly true in a situation where many other parts of the New Zealand economy are being forced to face up to radical change, with tariffs, import controls, and export incentives, for example, being reduced or phased out "retrospectively" after investments have been made.

Moreover, no submissions complained that the proposals would "retrospectively" provide benefits to many people, by making tax-free benefits which under the previous regime would have been taxable. (In at least some cases, it seems virtually certain that the benefit of receiving payments from superannuation schemes in a tax-exempt form would more than offset any possible reduction in the size of those payments.) In complaining about the "retrospectivity" of the proposals, however, a small number of submissions did acknowledge the very important point that the proposed changes to the taxation of superannuation were only one aspect of a larger tax reform programme, some parts of which involved significant reductions in both corporate and personal tax rates.

C. Distribution of benefits - Section 5.7 of the Consultative Document argued that the previous superannuation tax regime provided substantially greater benefits to high income earners than low income earners. A great many submissions questioned this argument, most simply noting that most of the members of employee superannuation schemes were low or middle income earners.

There is no doubt that a large number of New Zealanders earning quite modest levels of income are members of superannuation schemes. The Committee was not persuaded, however, that the benefits of the previous tax regime were distributed on the same basis as the membership of schemes. High income earners typically save more in tax (because of their higher marginal tax rates) for any given level of superannuation exemption than do low income earners; high income earners are able to save a higher proportion of their income, and shelter the income on that savings through superannuation schemes, than can low income earners; and, particularly in defined benefit superannuation schemes, it is the high income earners who receive overwhelmingly the largest part of the employer subsidies. (This last point is frequently overlooked. The reality, however, is that a great many of the contributors to defined benefit superannuation schemes receive little or nothing of the employer subsidies

5/...

notionally made on their behalf, with these subsidies effectively appropriated for the benefit of long-term, and therefore frequently higher income earning, employees.)

D. Lack of neutrality - One of the main arguments advanced by the Consultative Document for the proposed changes is that the changes would make the tax system more neutral, in that savings in the form of contributions to superannuation schemes would be treated in the same way as savings in all other forms. Most submissions questioned the desirability of neutrality as a goal, but even those submissions that accepted neutrality as a desirable objective argued that the proposed system fell well short of that objective. It was noted, for example, that in proposing to tax the income of superannuation schemes at 33% the Government's policy would act as a significant deterrent to those low income earners paying a marginal tax rate of less than 33%. The Committee recognises that this particular aspect of neutrality will be very difficult to avoid with anything other than a single personal tax rate.

Another point raised by a large number of submissions was the proposal to tax capital gains in superannuation schemes. Interestingly, a great many submissions accepted the desirability of having a comprehensive capital gains tax, and the Committee addresses this question later. But there was a virtually unanimous view on the part of the many submissions which raised the subject that, as long as capital gains are not subject to tax in the hands of private individuals, they should not be subject to tax within a superannuation scheme if neutrality is an important objective.

E. Security of private retirement plans - In large measure because the personal tax rate is now above the corporate tax rate, there was a widespread recognition on the part of many of those who made submissions that the proposed policy would create a quite considerable financial incentive for companies not to fund superannuation schemes, but rather simply to promise to provide retirement income to long serving employees on retirement. Such a move to unfunded "superannuation" could have a most undesirable effect on the security of the provision for retirement in the private sector because employees would be entirely dependent upon the long-term financial viability of their employers for retirement security.

F. Effect of proposals on level of savings - The great majority of those who made submissions expressed serious concern about the effect which the proposals would have on the level of savings for retirement. This concern was expressed in many different ways, but the common thread was that many employers would cease

6/...

providing superannuation schemes to their employees, that employees would cease to provide for their own retirement, and that as a consequence dependence on state-provided income would increase markedly over the next 10 to 20 years. A number of submissions pointed out that, because this would be the result of the Government's proposals, it was imperative that the whole issue of the provision of retirement income, both state and private, should be addressed at the same time.

This issue is of such fundamental importance to the matter under consideration that it is discussed further in Chapter 2.

G. Need for long-term stability - Many submissions expressed grave concern at the number of changes which had afflicted superannuation arrangements over the years since 1975. More than one submission claimed that there had been five major changes in the policy framework relevant to superannuation during that 13 year period. It was noted that the introduction of National Superannuation was itself a distinct discouragement to undertaking long-term retirement-orientated savings. The introduction of the National Superannuation surcharge increased that disincentive, by sharply reducing the return from private provision for retirement. Many submissions suggested that the December 1987 package, as it related to superannuation, was the final nail in the coffin of private provision for retirement.

Yet at the same time there was also widespread recognition that there is little prospect of National Superannuation surviving in its present form, given the demographic trends which we face. A considerable number of submissions argued in favour of there being some form of compulsion to belong to a funded superannuation scheme, rather along the lines proposed by the Hon. Mr Trevor de Cleene. And there was a widespread feeling that a bipartisan approach was crucially important in order to provide some form of certainty to those planning for their retirement. One individual submission wrote that "if ever there was a case for a common approach by the two major political parties then it must be over superannuation. If the Committee can give a lead to some consensus on this, if nothing else, then the effort will be totally worthwhile." The sentiment was expressed by many others, and the Committee comments further on this issue in Chapter 2.

7/...

Despite the criticism of Government's proposals, there was also, in many submissions, a recognition that the previous regime had some serious deficiencies as a way of encouraging provision of retirement income. It was recognised, for example, that much of the money that goes into superannuation schemes is withdrawn well before retirement. It was pointed out that, as a consequence, savings in this form is both enormously concessional from a tax point of view and quite ineffective as a means of providing for retirement income. Some submissions recognised also that most of the employer contributions in some defined benefit schemes went to high income participants only. It was pointed out, however, that these difficulties could in large measure be dealt with by appropriate legislative change relating to vesting, portability, and "preservation."

Commenting on the fairly wide range of tax treatments of superannuation schemes under the previous regime, several submissions favoured standardising on the exempt/exempt/taxed approach, ie. allowing contributions into superannuation schemes to be deducted from taxable income, allowing income to accrue within superannuation schemes on an exempt basis, but taxing the payments out of superannuation schemes. It was suggested that this was the internationally typical arrangement, and that it would retain a substantial incentive for the private provision of retirement income while avoiding the worst abuses possible under the present situation.

A very small number of submissions fully accepted Government's desire to move to a tax neutral situation, but argued that this objective would be much better achieved by moving to an exempt/taxed/taxed (E/T/T) regime, ie. allowing deductibility of contributions into superannuation schemes, while taxing both the income in those schemes and the payments from those schemes. It was claimed that, whereas no other country in the world had moved to the taxed/taxed/exempt (T/T/E) regime proposed in the Consultative Document, four countries had moved to an E/T/T regime, namely Denmark, Finland, Norway, and Spain.

1.4 Brief Summary of Key Recommendations

Much of this report is devoted to a commentary on the implementation and administration of the proposals contained in the Government's Consultative Document, as requested in our terms of reference. But the Committee was sufficiently impressed by the arguments of those who claimed that the Government's proposals would lead to both a significant reduction in aggregate savings, and a substantial disruption of capital markets in the short-term, to recommend to the Government that the proposals themselves should be fully reviewed in a wider context.

8/...

We recognise that, at this stage, with some of the proposed tax changes already in place, there is little prospect of any fundamental change in the proposed regime for 1988/89. In any event, the Committee recommends that this regime (subject to modifications outlined in Chapter 4) should be adopted for lump sum superannuation schemes. But it was also the unanimous view of the Committee that -

a) Every effort should be made to ensure a bipartisan approach to the whole question of the provision of retirement income in New Zealand.

b) The Government should urgently review the feasibility of continuing National Superannuation on the present basis and, if found appropriate, make it clear at the earliest opportunity that present levels of state-provided retirement income will not be available in future. (The Committee's reason for this recommendation is that the proposed non-concessional tax regime to apply to the private provision of retirement income provides a substantial disincentive for such private provision, when there remains access to a generous, but income-tested, state-provided retirement income.)

c) In this context, the Government should give serious consideration to the adoption of a "modified E/T/T" regime for pension schemes (Retirement Income Funds, or RIFs).

CHAPTER 2 - A CONCESSIONARY TAX REGIME?

2.1 The Arguments Against a Concessionary Tax Regime

At section 5.8 of the Consultative Document, the argument that special tax privileges are justified for superannuation is strongly rejected. It is claimed that "from an economic perspective there is nothing inherently good (or bad) about savings, any more than there is anything inherently bad (or good) about consumption. In general, people can be expected to make consumption and savings choices in a way which, given constraints which the Government imposes, maximises their welfare over time. In the absence of other considerations, no Government intervention to alter the level or rate of savings is called for."

The Consultative Document goes on to point out that "the available evidence does not suggest that New Zealand's past poor economic performance is the result of a paucity of savings. Instead it has been the result of the inefficient allocation of resources. Our savings to gross domestic product ratio has been about average for OECD countries yet our growth has been markedly below average."

It is also pointed out that it is not clear "that tax concessions to increase the after-tax return on savings necessarily lead to an increased rate or level of savings. While on the one hand an increased after-tax return from savings increases the relative incentive to save, on the other hand it results in those who have some savings target (such as an adequate level of retirement income) having to save at a lower rate in order to meet that target."

Finally, the Consultative Document notes that "even if the Government did wish to increase the rate of private savings, there is no obvious reason why it should do so by favouring superannuation ..... over other forms of savings."

2.2 Reaction of the Consultative Committee to the Case for Providing No Tax Privileges for Saving

The Consultative Committee has no difficulty accepting the argument that it has been the misallocation of New Zealand's resources over several decades, rather than a significant paucity of resources, which has been primarily responsible for the very slow growth of the New Zealand economy over that period.

We also accept that, in principle, "there is nothing inherently good (or bad) about savings". We find great difficulty, however, accepting that, at this particular stage in New Zealand's history, we can be indifferent to the level of savings. By most objective assessments, New Zealand's net overseas indebtedness has now risen close to the point where it imposes significant constraints on future

economic growth. That net overseas indebtedness reflects, of course, simply the accumulation of many years of deficit in the current account of the nation's balance of payments, reflecting in turn our long-standing propensity to spend more than we produce as a nation - that is, a long-standing propensity to save too little.

Moreover, the Committee finds it difficult to accept that taxation has no effect on aggregate savings. The Consultative Document argues that providing a tax concession to savings might in fact result in a reduced rate of savings because of the reduced rate of savings required to reach any particular savings target. At the same time it also appears to be Government policy to reduce income taxes, on the grounds that such reductions will stimulate greater production. The Committee shares Government's view that reducing income taxes is likely to result in increased production, even though rigorous academic proof of that proposition is not available. On balance, it seems likely that savings will be stimulated by reducing taxes on savings.

At the same time, the Committee has no argument with the proposition in the Consultative Document that there is no good basis for providing tax privileges to particular types of institutions. It also acknowledges that there is much in the overall tax reform programme - dividend imputation, GST, and lower company tax rate to mention the major items - which does reduce the rate of tax on savings.

2.3 Effect of State Provision of Retirement Income

The Consultative Document proposal is premised on the assumption that there is no adequate reason for providing any form of concessionary treatment for superannuation. In other words, it is premised on the desirability of tax neutrality. The Committee endorses the general principle of neutrality in tax matters.

Unfortunately, however, the existence of National Superannuation means that there is already a significant lack of "neutrality" in the tax system as it relates to the provision of retirement income, and, as noted in Chapter 1, the tax surcharge on National Superannuation introduced by the Government in 1984 introduces a further bias into the system. In other words, while the proposal in the Consultative Document may increase "neutrality" between the tax treatment of savings for retirement and other forms of savings, it actually leaves the total tax/benefit system with a significant bias against the private provision of retirement income.

11/...

If a generous retirement income were to continue to be provided by the state, and even more if access to that benefit were to continue to be means-tested, by a surcharge or other technique, the Committee believes that a logical argument could be made for some tax preference for savings for retirement, on the basis that state-provided retirement income would be appropriately reduced to the extent that tax concessions had been used to build a private retirement income. Put another way, for as long as the state provides retirement income for those who need it, all taxpayers have an incentive to encourage individuals to provide for their own retirement. This could be reflected in the tax system.

The fact that the tax concessions of the previous superannuation regime were an ineffective and expensive way of encouraging private provision for retirement income does not, in itself, constitute a good reason to introduce a bias against such private provision into the tax/benefit system.

2.4 Prospects for National Superannuation

In fact, there appears little or no prospect of National Superannuation continuing in its present form.

Prior to 1975, state-provided retirement income amounted to between 27% and 35% of the national average wage, and was equivalent to between 2.8% and 4.0% of national disposable income. With the introduction of National Superannuation over the years 1976 to 1979, however, retirement income provided by the state increased substantially to between 44% and 47% of the national average wage, and the cost of such provision rose to the point where, in 1986, it amounted to 8.5% of national disposable income. (The figures are set out in the table below.)

THE STATE'S AGE BENEFIT

Year	% National Average Wage	Cost as % National Disposable Income
1940	28.9%	2.8%
1945	27.0%	2.8%
1950	35.0%	3.4%
1955	27.4%	3.4%
1960	32.5%	3.7%
1965	30.8%	3.4%
1970	30.7%	3.5%
1975	31.4%	4.0%
1979*	44.0%	7.4%
1980	44.0%	7.0%
1985	46.8%	8.1%
1986	46.3%	8.5%

*1979 was the first full year of National Superannuation

12/...

In the 1986/87 financial year, 14.7% of the total population was entitled to National Superannuation, and the fiscal cost to Government was $3.65 billion gross ($2.75 billion net of tax) - amounting to 56% of the total Social Welfare vote, or approximately one-sixth of all Government spending that year.

Even if the current cost of National Superannuation is acceptable, and the Committee has serious reservations on that point, the Committee has not seen any serious argument that the cost is sustainable over the next 30 or 40 years, with the substantial ageing of the New Zealand population which now looks certain to take place over that period. Indeed, the Committee was advised that the present level of National Superannuation benefits would have to be reduced in real terms by some 40% by the year 2030, if the total cost to the nation was to be held static in relation to national income, because of the prospective demographic trends.

2.5 The Political Problem in Changing National Superannuation

The Committee recognises that there is an enormous difficulty in changing National Superannuation in any way, as the Government found when it introduced the surcharge.

The difficulty lies partly in the simple electoral fact that some 22% of all voters are currently entitled to National Superannuation, and any reduction in that benefit is therefore liable to trigger a significant political backlash.

In addition, there is also a widespread, if totally erroneous, view held by many people, particularly those drawing National Superannuation, that they are "entitled" to National Superannuation, having "paid for it" over the years of their working life. While it is true that there is, in some sense, a "moral entitlement" to state-provided retirement income on the part of those who have paid taxes over their working lives, it is simply untrue to suggest that those drawing National Superannuation have "paid for it". This is so both literally, in the sense that the taxes which current National Superannuitants paid during their working lives actually paid for the superannuation paid to an earlier generation, and more generally, in that the superannuation paid to that earlier generation by current National Superannuitants was on a substantially less generous scale than that now received by National Superannuitants. But erroneous or not, the perception exists, and is a powerful motivating force for many of the National Superannuitant lobby groups.

13/...

On the other hand, it will get politically more difficult to change National Superannuation with every passing year, as the number of those entitled to receive it steadily increases. By the year 2030, for example, it is anticipated that 32% of all voters will be entitled to National Superannuation, a substantially more difficult dilemma that currently faces the Government.

2.6 Possible Options

The options facing Government are theoretically numerous. The Government could, of course, move to some form of compulsory savings for retirement income, along the lines proposed by the Hon. Mr Trevor de Cleene. A compulsory scheme would not require tax incentives, although these would no doubt make the introduction of such a scheme more politically acceptable. State-provided retirement income would only be available as a transitional measure for those who do not have time to save up sufficient money to replace it, and as a way of supplementing the retirement income of those who have not been in the paid workforce.

If the Government wished to stay with voluntary private provision for retirement income, there would, in principle, appear to be at least eight options, reflected in the following matrix:

State provision of retirement income	Tax regime re private provision for retirement income	
	Concessionary	Non-concessionary
None	-	-
Modest universal benefit	Pre-1975 regime	-
Generous universal benefit with no means test	1976-1984 regime	-
Generous universal benefit with means test	1984-1987 regime	Regime proposed on 17/12/87

Prior to 1975, the state provided a modest superannuation benefit ("universal") - means-tested from 60 to 65, and universal from 65. There was a concessionary tax regime vis-a-vis private provision, and overall a moderate stimulus to private provision.

After the introduction of National Superannuation in 1976 - a generous state system - there was obviously rather less incentive for private provision, and this incentive was still further reduced by the introduction of the surcharge in 1984. (Some incentive still exists, of course, both for those who do not expect their savings for retirement to "trigger" the surcharge, and for those whose retirement savings can generate an income well above the level where National Superannuation is totally abated.)

14/...

The proposed removal of all tax concessions relating to the private provision of retirement income produces a situation where, for many income-earners, there is little if any incentive to save for retirement.

The redeeming feature of the present situation, paradoxically, is that an increasing number of people no longer believe that National Superannuation will be available when they reach retirement age.

2.7 The Special Problem of the Government Superannuation Fund

While the existence of a generous but means-tested state system of retirement income is the most serious obstacle to the creation of a totally "neutral" regime for the private provision of retirement income, the Committee also became concerned during the course of its deliberations at the impact which the Government Superannuation Fund has on private superannuation schemes.

Like many private schemes, the GSF provides defined benefit superannuation to those who belong to it. Unlike private schemes, however, the GSF relates retirement benefits to the average of a contributor's real (inflation-adjusted) salary over the five years prior to retirement (most private schemes relate retirement benefits to the average of a contributor's nominal salary over the three years prior to retirement), and then adjusts those benefits regularly to reflect inflation: no private scheme can hope to offer benefits of comparable value, and the GSF can do so only because it has the unlimited backing of the taxpayer.

The Government is already aware of the considerable problems caused by the GSF for the Government's fiscal position, and for adopting a rational basis for remunerating public servants. (To adopt a salary structure comparable with that in the private sector is to over-pay those public servants who are members of the GSF, while to adopt a "non-competitive" salary structure is to under-pay those who do not belong to the GSF.)

In the context of the proposed changes in the tax regime applicable to the private provision of retirement income, changes which will of necessity mean significant reductions in the post-tax benefits received by many members of private superannuation schemes, it would be quite intolerable if the members of the GSF were insulated from changes of that kind simply by virtue of the Government's ability to "write a cheque on the taxpayer". The simplest way to handle the situation would be to renegotiate the benefits receivable by members of the GSF on the assumption that the GSF were a fully funded scheme. This would put members of the GSF on the same footing as members of private sector schemes.

15/...

More generally, the Committee has serious reservations about the desirability of continuing with the provision of fully inflation-adjusted pensions for members of the GSF, and recommends that this preferential benefit be withdrawn in the context of the renegotiation of benefits.

2.8 Desirability of Bipartisan Approach

As already noted in Chapter 1, the Committee received a large number of submissions which argued strongly for a bipartisan approach to superannuation policy. The argument of those submissions was that it is simply intolerable for policy towards retirement income to be changed every two or three years, in a situation where stability and certainty are of fundamental importance if long-term retirement planning is to be encouraged. The Committee strongly endorses the need for stable policy in this area, and if that means a bipartisan approach is required, strongly endorses that also.

While New Zealand's recent political history must make one uncertain about the prospects for successfully negotiating a bipartisan approach to this matter, it is also true that any political party which occupies, or aspires to occupy, the Government benches knows that the present shape of National Superannuation is now, or will shortly be, unsustainable. This should in itself provide some basis for a bipartisan approach.

Moreover, it is perhaps also fair to note that both major political parties have been to some extent discredited in the eyes of the electorate in the superannuation policy area. The National Party is blamed for introducing the present programme of state-funded retirement income, at a level which is fiscally irresponsible and at an age which has apparently had a major effect in encouraging the most skilled members of the workforce into early retirement. The Labour Party is blamed for changing the tax basis of National Superannuation, after leading the public to believe that, if elected, it would make no change to National Superannuation.

The reality is that National Superannuation must be changed, and its total cost reduced. It is even more important if Government intends to proceed to introduce a non-concessionary tax regime with respect to superannuation that Government's intention to reduce National Superannuation is made clear at an early date so that people can start making appropriate private provision for retirement income.

16/...

The Committee believes that one way of reducing the fiscal cost of National Superannuation would be to provide some tax concessions - clearly defined, targeted, and limited - for the private provision of retirement income, constructed so as to ensure that those concessions were at least fully offset by savings to the state retirement income scheme of the future. We see this as being "neutral" (and thus entirely consistent with the objectives of the Government's tax reform programme), while at the same time involving substantially less risk that large numbers of existing superannuation schemes will be wound up than would be the case with the proposal in the Consultative Document. This issue is further addressed in Chapter 3.

CHAPTER 3 - NON-CONCESSIONARY OPTIONS

3.1 Taxed/Taxed/Exempt

The Consultative Document proposed that contributions to superannuation schemes should be from tax paid income, rather than being deductible within certain limits; that the income earned by superannuation schemes should be taxable; and that the payments from superannuation schemes, whether lump sum or pension, should be exempt from taxation. The regime, referred to for ease of reference as T/T/E, would put savings for retirement on the same tax footing as all other forms of saving.

There are some important advantages of such a regime. First, and most obviously, it has the advantage of being consistent with an income tax regime, and consistent also with the treatment of other forms of saving. Secondly, it is already the tax regime applicable to post-1984 personal lump sum superannuation schemes, and for these schemes at least there would be no transitional problems. Thirdly, of all the options, this one is least likely to disadvantage those currently drawing, or about to draw, benefits from superannuation schemes, because it would make those benefits exempt from tax, even though under the previous regime many of them would have been subject to tax. From the Government's point of view, moreover, a T/T/E regime would provide a short-term gain in terms of tax revenue, estimated at in excess of $500 million.

On the other hand, like any regime which reduces tax concessions on savings, the proposed T/T/E regime would probably have a negative effect on aggregate savings. Both those who made submissions and Treasury officials gave the Committee a large number of references to overseas studies, relating the level of aggregate savings to the incentives provided for retirement savings. The Committee felt that some of those who made submissions were being unduly alarmist: clearly, some of the money which is now going into superannuation schemes, and which might not go into superannuation schemes if the Government proposals proceed, would be used to increase savings in other forms, possibly by a more rapid reduction in residential mortgages.

At the same time, the Committee shares the concern expressed by those who made submissions that on balance the Government's proposals would probably result in some reduction in aggregate savings. This is especially true at a time when the state continues to provide a generous retirement income, as argued in Chapter 2. At a time when the ongoing deficit on current account establishes a *prima facie* case that New Zealand is already saving too little, any policy which would reduce aggregate savings, even if only slightly, must clearly be a matter of concern.

18/...

Of even greater concern perhaps is the immediate impact of a T/T/E regime on investment activity. On the basis of the submissions received, and information available to the Committee from other sources, we believe that a T/T/E regime in the form proposed in the Consultative Document would lead to a significant number of superannuation schemes being wound up, with potentially very serious disruptive effects on the New Zealand capital market. One large funds manager estimated that up to 30% of the funds in New Zealand superannuation schemes at the present time could be liquidated as a result of schemes being wound up if the present proposals proceed. Others suggested that the strong desire to remain liquid felt by many superannuation fund managers at the present time was having a most depressing current effect on New Zealand capital markets, to the extent that some companies were contemplating a move offshore primarily because of the impossibility of raising equity funds from institutional sources in New Zealand. (Since the closing of submissions on the Consultative Document, the results of a survey of employers concerning their intentions with respect to superannuation have been published ("National Business Review", 3 June 1988). The survey indicated that about one-third of those canvassed intended to wind-up their superannuation schemes in the light of the proposals in the Consultative Document.)

The reasons for this possibly drastic effect on existing superannuation schemes appeared to be of three kinds. First, a number of submissions suggested that contributors would be sceptical about the proposed exemption of payments from superannuation schemes after retirement, as the "trade-off" for the loss of deductibility on payments to superannuation schemes. Many people simply do not believe, apparently, political commitments to leave what are perceived as income flows exempt from taxation over the next 30 or 40 years. The Committee felt that this concern on the part of contributors was somewhat irrational: there are, after all, other payments of an "income nature" which are exempt from tax (such as payments from trusts), and nobody appears to fear that these might be changed. But irrational or not, the concern appears widespread, and was expressed by both professional tax advisers and ordinary contributors. To meet this concern, the Government would need to publicise the rationale for the changes. Alternatively perhaps, the benefits could be made formally taxable, with offsetting imputation credits.

Secondly, many employers argued that they would not be willing to continue funding superannuation schemes if they had to face the substantial increase in cost implied by fringe benefits tax. It would be easier, it was argued, to discontinue contributions to superannuation and to pay the same dollars in extra wages. This argument too was not entirely rational, in that the argument assumed that the two options were of equivalent benefit to employees.

19/...

(Contributing a dollar plus fringe benefits tax to a superannuation scheme on behalf of employees clearly has significantly greater benefit to employees than paying a dollar to them in taxable wages.) But there was a presumption that, rather than renegotiate the employer contributions down to the previous total cost, employers would prefer to wind-up schemes. The Committee believes that this should be dealt with, if a T/T/E regime is finally adopted, by replacing the fringe benefits tax by a tax on the receipt of the employer's contributions by the scheme: this would leave the effective cost of employer contributions unchanged from the previous regime.

Thirdly, and perhaps most serious of all, the proposed regime would make it significantly less expensive for companies to operate "unfunded" superannuation schemes than to operate funded schemes. Under the proposed regime, contributions by both employers and employees are effectively made out of income taxed at the top marginal tax rate of 33%, whereas refraining from making contributions to a superannuation scheme would effectively incur tax at the company rate of 28%. Under the proposed regime moreover, income within a superannuation scheme would also incur tax at the top marginal tax rate of 33%, whereas retaining investment funds within the employer to meet eventual pension obligations would incur tax at only 28%. In a situation where retaining a funded superannuation scheme has this sort of tax disadvantage, and involves a complicated renegotiation of scheme benefits with members, the attraction of winding up schemes becomes only too obvious. This is particularly true because such winding up would involve paying out, tax free, lump sums which are substantially greater than most members would be likely to receive if the schemes were to be continued, and because continuing would involve those same members in increased cost of contributions (because of the removal of deductibility). This incentive to wind-up schemes would be diminished by ensuring that contributions made by employers were taxed at the corporate rate (currently 28%) rather than the top marginal rate for individuals, and taxing scheme income at 28% rather than 33%. Both of these proposals are recommended in Chapter 4 if a T/T/E regime is adopted.

3.2 Exempt/Taxed/Taxed

Because of these difficulties, the Committee devoted some time to a consideration of other options. As mentioned in Chapter 1, a very small number of submissions fully accepted Government's desire to move to a tax neutral situation, but argued that this objective would be much better achieved by moving to an E/T/T regime, i.e. allowing deductibility of contributions into superannuation schemes, while taxing both the income in those schemes and the payments from those schemes. As the Consultative Document itself notes, at

Section 3.3, an E/T/T regime, while not strictly part of an income tax regime, is equivalent to a T/T/E regime under certain assumptions (basically related to stability of personal income tax rates over time, and the identity of the interest rate at which the taxpayer is prepared to lend money to Government and the rate at which Government is prepared to borrow).

An E/T/T regime would have some important advantages as compared to the T/T/E regime proposed in the Consultative Document:

A) We believe that an E/T/T regime would have a less damaging effect on private retirement savings than would a T/T/E regime, because it does not depend on convincing contributors that their pensions will remain exempt from tax in 40 years' time.

B) Our judgement is that an E/T/T regime, by continuing to provide deductibility for contributions now, would result in far fewer schemes being wound up than would be the case under the proposed T/T/E regime, with very significant benefits for investment activity in the short to medium term. We believe this to be the case notwithstanding the fact that, from an economic point of view, both regimes are non-concessionary.

C) An E/T/T regime would avoid the windfall gains which would accrue to many parties from the T/T/E regime proposed in the Consultative Document. (This is because many people went into superannuation schemes on the explicit understanding that 75% of the benefits paid out of such schemes on retirement would be taxable. A T/T/E regime would enable the benefits from such schemes to be paid without incurring tax.)

D) Another major advantage of the E/T/T regime is that it would be significantly easier to integrate with the National Superannuitant surcharge. All payments arising from superannuation schemes would be taxable, and in principle would be included for the calculation of surcharge. (On the other hand, the payment of part of the benefits in lump sum form would be an effective way of avoiding some of the effect of the surcharge.)

E) It would be possible to encourage superannuation schemes to provide the retirement income for which they were originally intended by making the deductibility of contributions conditional upon satisfactory provision for portability and preservation, perhaps by obliging benefits to be taken in pension form.

21/...

3.3. Disadvantages of an Exempt/Taxed/Taxed Regime

There are, however, several significant disadvantages of an E/T/T regime.

First, the transition from the tax regime which prevailed before 17 December 1987 to an E/T/T regime would be more difficult than to a T/T/E regime. Moving from the previous regime to a T/T/E regime would have the effect of providing windfall gains to many current contributors, as indicated, and that might be seen as objectionable where the beneficiaries of those gains have been actively using the previous concessionary regime to their benefit. On the other hand, moving from the various regimes which prevailed prior to 17 December 1987 to an E/T/T regime would mean that a large number of contributors who had counted on receiving at least part of the benefits from their superannuation schemes on a tax-exempt basis would in fact find themselves liable to tax on those benefits. Moreover, for those receiving a pension there would be no offset for the taxation of fund income in the form of an exemption of benefits. This would increase the possibility of a reduction in post-tax benefits to current pensioners. This might be seen as particularly harsh, and to involve an excessive degree of retrospectivity, especially for those in or close to retirement.

The second disadvantage of an E/T/T regime is that such a regime would have an adverse effect on Government's tax revenue in the short-term in comparison to a T/T/E regime. The annual cost is likely to be less than $200 million

It is very important to recognise, however, that that short-term loss of revenue would be more than fully offset, in present value terms, by the gain to Government revenue over the long-term. This follows from the fact that, insofar as all future contributions to superannuation schemes are concerned, a T/T/E regime and an E/T/T regime are both non-concessionary regimes, on reasonable assumptions about discount rates and stable tax rates, and therefore have the same present value effect on Government revenue. However, there is a marked difference between a T/T/E regime and an E/T/T regime insofar as the funds already in superannuation schemes are concerned. Under a T/T/E regime those funds will emerge in a tax-exempt form, whereas under an E/T/T regime, those existing funds will come out in a taxed form. If there were no transitional arrangements at all, the E/T/T regime would therefore have a benefit to Government tax revenue, in present value terms, of something approaching $3 billion (being the total funds

22/...

in superannuation schemes currently of about $11 billion multiplied by the personal tax rate). Government could afford to offer quite generous transitional arrangements to smooth the path to an E/T/T regime and still be significantly better off in tax revenue terms than under a T/T/E regime. The only problem would be a short-term difference in tax revenue.

But it is important to recognise that the short-term gain to Government tax revenue arising from a T/T/E regime in comparison to an E/T/T regime is not a gain in the long-term at all, but rather a bringing forward of future tax revenue, and that in a rather costly manner. (Both regimes, of course, provide more tax revenue than the variety of regimes prevailing before 17 December 1987.) That is true even if a T/T/E regime and an E/T/T regime produced similar fiscal costs for the state-provided retirement income scheme, because of the gain in tax revenue, in present value terms, from the E/T/T regime. If an E/T/T regime also led to fewer superannuation schemes being wound-up, and therefore a reduced call on state-provided retirement income, as we expect, the gain in tax revenue from a T/T/E regime in the short-term is even more clearly achieved at the expense of increased fiscal costs in the long-term.

Thirdly, while an E/T/T regime is easier to integrate into the National Superannuitant surcharge than is a T/T/E regime, it does create some problems in relation to the Family Support programme. It would be possible, for example, for a contributor to minimise his taxable income by channelling large amounts into a superannuation scheme, thus increasing his eligibility for Family Support payments. This is a situation where the contributor's <u>effective</u> marginal tax rate (taking into account the abatement of entitlement to Family Support) is much higher than he expects it to be after retirement, and if his expectations prove correct, the E/T/T regime will have proved to be concessionary. This problem can be dealt with in principle by requiring applicants for Family Support tax credits to add back superannuation contributions made by them (or on their behalf) before determining eligibility for Family Support, and could in any case be limited by placing an upper limit on the deductibility of contributions.

Finally, while we believe that fewer superannuation schemes will be wound-up if an E/T/T regime is adopted than if a T/T/E regime is adopted, it is still true that, even with no means test on state-provided retirement income, there would be little incentive for many people to contribute new funds to a superannuation scheme, or indeed even maintain existing funds in a superannuation scheme. With a means test applying to state-provided retirement income, in the form of the National Superannuation surcharge, there is a positive disincentive to remain within a superannuation scheme, as noted in Chapter 2. There remains, therefore, a significant

risk that large numbers of superannuation schemes would be wound-up, with resultant damage to already-fragile capital markets. If any transitional arrangements for now-exempt lump sum benefits involved a gradual increase in the tax applied to such benefits over time, the risk of schemes being wound-up quickly would be greatly increased.

In principle, this problem could be dealt with by compulsory preservation, in other words by obliging contributors to leave funds within superannuation schemes until, say, retirement on or after 55, death, or permanent disability. The Committee initially saw some advantages in this idea. But it was rejected, on the grounds that it was unreasonable to "preserve" funds which had been placed into superannuation funds when the tax regime was concessionary (and on the understanding that they could be withdrawn under a number of circumstances) after the tax regime becomes non-concessionary.

3.4 A Possible Compromise

The Committee eventually reached the conclusion that there was no single solution which would precisely meet all reasonable objectives - of providing a non-concessionary tax regime, of avoiding increasing dependence on state-provided retirement income, of avoiding serious disruption to capital markets, and of avoiding any retrospective change in the rules affecting existing schemes.

On balance, and as indicated in Chapter 1, we recommend that, whatever is done for the 1988/89 financial year, serious consideration be given to the introduction of a "modified E/T/T" regime for all approved pension schemes in future years, in the context of the comprehensive (and hopefully bipartisan) review of retirement income also proposed earlier. By "modified" we mean a regime which allows contributions to be deductible and taxes all fund income, but taxes only in part the eventual payment of benefits. We envisage that all approved pension schemes, or retirement income funds (RIFs) as we would prefer to call them, would be able to commute up to 25% of the total benefits due on retirement into a lump sum and that that lump sum would be non-taxable up to some limit, provided that no benefits were paid out prior to eligibility for state-provided retirement income. Beyond that limit and for the balance of the benefits which would be taken in pension form, tax would be levied in full, plus any surcharge designed to reduce the amount of state-provided retirement income required.

24/...

The logic of this proposal related to pension schemes is as follows:

(A) It allows a resumption of the deductibility of contributions to all approved pension schemes, by both personal contributors and employers, and is thus unlikely to lead to nearly as many schemes being wound up as would a T/T/E regime.

(B) It involves little or no change in the manner in which benefits from pension schemes are taxed now, at least for those who withdraw after age 50, and proposes a regime which is "credible" - in other words, it involves taxing what are seen as income flows (pensions) and exempting lump sums.

(C) While it is in a narrow sense a slightly concessionary regime, if the limit on the amount of lump sum which can be paid without incurring tax and the rate of surcharge are correctly calculated, the overall concessionality can be kept very small. Indeed, in principle, concessionality can be eliminated entirely. In other words, what the Government provides by way of concession to encourage the private provision of retirement income can be almost fully offset, fully offset, or more than offset by savings in state-provided retirement income. The Committee itself supports the principle of a non-concessionary regime and would therefore support a structure of limits and rates which exactly clawed back the tax exemption on the lump sum by subsequent savings for the state retirement income scheme.

What of the tax treatment of lump sum superannuation schemes? We recommend that they fall under the T/T/E regime proposed in the Consultative Document, subject only to the replacement of the proposed fringe benefits tax on employer contributions by a tax on those contributions in the scheme itself (or through a withholding tax paid by the employer on behalf of the scheme).

We reached this conclusion for three reasons. First, lump sum schemes are not, by definition, designed to produce "retirement income", and so should not, in our view, qualify for the departure from normal income tax rules involved in the E/T/T regime envisaged for RIFs.

Secondly, if all amounts which would be payable tax-free if lump sum schemes were wound up as at 30 June 1988 were preserved as a tax-free lump sum entitlement, as proposed for the RIF regime in Chapter 4, <u>all</u> the assets in such schemes would be payable tax-free. There thus seems little point in keeping them in an E/T/T regime, and there would certainly be no loss of tax revenue in letting those assets emerge tax-free.

25/...

Thirdly, many lump sum schemes are already on or close to a T/T/E regime, as can be seen below.

Approved Schemes	Contributions	Fund Income	Benefits
Employee			
Pre-1982	exempt	exempt	exempt
Post-1982	exempt	taxed	exempt
Personal			
Pre-1982	exempt	exempt	exempt
1982-1984	exempt	taxed	exempt
Post-1984	taxed	taxed	exempt
Non-approved	taxed	taxed	exempt

Adopting a T/T/E regime for all lump sum schemes involves no change for post-1984 personal lump sum schemes, and non-approved schemes. It involves no change for the funds which are already in post-1982 employee lump sum schemes, or in 1982-1984 personal lump sum schemes (because the fund income in them is already taxed). Only in respect of pre-1982 lump sum schemes, both employee and personal, might it be argued that there is an element of retrospectivity for existing funds in the scheme, in that contributions were made in the expectation of the fund income being exempt from tax. In fact the Committee does not regard that as a "retrospective" change, any more than changing an export incentive, up or down, 10 years after an export venture is bought can be regarded as retrospective. The taxation of future fund income leaves past income unaffected. Moreover, the contributors to these schemes have already enjoyed a tax concession on their contributions, and on fund income to date, in schemes which arguably have little to do with the provision of retirement income. They have, in principle, the option of winding up their schemes and withdrawing the assets without incurring tax. That hardly seems unreasonably oppressive, and would see a non-concessionary regime introduced in the approximately 25% of all superannuation schemes (by value of assets) represented by lump sum schemes.

We have expressed great concern in this chapter about the effects of a simple T/T/E regime on New Zealand capital markets, and therefore on levels of economic activity. There is no way of being certain, of course, how our proposals would affect these matters. On balance, however, we would expect the impact on capital markets to be substantially less damaging than a simple T/T/E regime for all superannuation schemes would be.

We recognise that adoption of a modified E/T/T regime for pension schemes would have the disadvantage of involving a short-term loss in Government revenue. On the basis that the regime were adopted from 1 April 1989 for pension schemes, there would be no revenue effect in 1988/89 and we estimate that the cost would be approximately $120 million for 1989/90, and less in subsequent years. We note that the 17 December 1987 statement made it clear that the proposed reductions in both corporate and personal tax rates were only possible because of the base-broadening measures also being taken at that time. The short-term reduction in Government revenue is fairly small, however, and in any event would be more than fully offset over time by the economic and fiscal benefits of a "modified E/T/T" regime.

Perhaps most important of all, however, while any short-term adverse effect on the Government's fiscal position would have deleterious effects on interest rates, and therefore on investment activity, these effects must be compared with the consequences for interest rates, and investment activity, of a simple T/T/E regime for all superannuation schemes, as proposed in the Consultative Document. If, as most submissions contended, and as the Committee is inclined to agree, the T/T/E regime led to a significant liquidation of the assets of superannuation funds over the next year or so, this would certainly put upward pressure on interest rates as funds sought to realise assets, and would almost certainly have a seriously adverse effect on investment activity.

The final chapter of this report summarises the Committee's views on the implementation of both the T/T/E regime proposed in the Consultative Document, and the modified E/T/T regime preferred by the Committee for retirement income funds.

27/...

CHAPTER 4 - MAIN CONCLUSIONS

This chapter provides a summary and overview of the key features of both the T/T/E and the E/T/T regimes which may be used for superannuation schemes. The detail of our recommendations, and some other features not covered in this summary, are contained in the attached appendices.

4.1 Key Features of the Taxed/Taxed/Exempt Regime

The Consultative Document recommended the application of a T/T/E regime to all superannuation schemes. In Chapter 3, we endorse the proposal to apply such a regime to lump sum schemes (which we prefer to call Retirement Lump Sum Funds, or RLSFs) and recognise also that, notwithstanding our recommendation that Government give serious consideration to applying a modified E/T/T regime to pension schemes (Retirement Income Funds, or RIFs), Government may wish to continue with a T/T/E regime for these also. Accordingly, the Committee devoted considerable time to discussing the key recommendations of the Consultative Document.

4.1.1. Deductibility of Contributions

The regime recommended by the Consultative Document had several key features. First it recommended that the deductibility of contributions by members to superannuation schemes should be abolished. This change has already been enacted, and is consistent with a T/T/E regime.

Secondly, the Consultative Document recommended that, in order to ensure that employer contributions to superannuation schemes, whether contributions in cash or contributions in kind, were recognised as a form of employee remuneration, such contributions should be subject to fringe benefit tax. As far as cash contributions are concerned, this too has already been enacted.

We received a large number of submissions on this matter. All agreed that it would be impractical to attribute employer superannuation contributions to individual scheme members, and levy tax on that basis. However, it was strongly argued that of the other two options identified by the Consultative Document - fringe benefit tax or taxing employer contributions as fund income - the latter would more efficiently meet the Government's objectives.

We found the arguments in favour of taxing employer contributions in the hands of the superannuation fund to be persuasive. We concluded that levying FBT on these cash contributions would create unnecessary compliance costs for many employers who, since they do not provide their employees with any other form of fringe benefit, have been

28/...

exempted from the requirement to file quarterly fringe benefit returns. Moreover, the incidence of the tax burden is more likely to be substantially borne by employers, at least in the short-term, if tax is collected through the FBT system. Both of these factors would seem likely to lead a number of employers to cease making superannuation contributions and to close down their employee superannuation schemes when, if the same tax were levied directly on the scheme, this may not happen.

Accordingly, the Committee recommends that employer contributions to registered schemes should be subject to a final withholding tax at the rate of 28%. Employer contributions to non-registered schemes would remain subject to FBT and non-assessable in the hands of the superannuation fund.

As far as contributions in kind are concerned, applying FBT to such employer contributions creates some major practical difficulties. Many submissions felt that the recommendation of the Consultative Document was, in this respect, impractical, given the difficulties of quantifying many of the costs which employers incur on behalf of schemes. The Committee was persuaded about the practical difficulties involved in applying FBT to the provision of services to superannuation schemes, and accordingly believes that no FBT should be payable where the benefit is provided to the superannuation scheme on the employer's own premises.

4.1.2 Shareholder Employees

As far as superannuation schemes for shareholder employees are concerned, the Committee saw no need to make a distinction between employer contributions for shareholder employees and other employer contributions. In other words, the Committee decided that these contributions should be fully deductible to the employer and should be assessable in the hands of the superannuation scheme, or liable for FBT, as the case may be.

4.1.3 Taxation of the Income of Superannuation Schemes

The Consultative Document recommended that income derived by a superannuation scheme should be taxed as if it were being received by scheme members, the so-called "proxy concept". The Committee agreed with this basis of taxing fund income.

Notwithstanding this, the Consultative Document recommended that superannuation schemes should be liable to taxation on realised capital gains. As already noted, a great many submissions accepted the logic of having a capital gains tax in New Zealand, but almost without exception those who

commented on this matter pointed out the inconsistency of applying a capital gains tax to gains realised by superannuation schemes while at the same time arguing that the income of such schemes should be taxed as if it were in the hands of members.

The Committee shares the view of the Consultative Committee on International Tax Reform and Full Imputation that an extension of the tax base to include capital gains would be consistent with the Government's general tax reform programme, and with the tax reforms being implemented by other western countries. At the same time, the desirability of such reform requires close analysis in the light of the practical problems involved, and in view of the fact that realised capital gains are not currently subject to tax in the hands of private individuals, we cannot support the recommendation in the Consultative Document that those gains should be taxable within superannuation schemes at this time.

In defining the fund income which should be liable to taxation, the Consultative Document also recommended that the non-investment costs of superannuation schemes should not be deductible. This matter too was the subject of much comment from those making submissions, and most argued that such treatment was unfairly discriminatory against superannuation schemes in comparison to other financial institutions.

There are a number of arguments both for and against allowing the deductibility of non-investment costs, and these are canvassed in Appendix 1. On balance, however, the Committee disagrees with the Consultative Document, and recommends that non-investment costs should be deductible in determining the taxable income of superannuation schemes.

The Consultative Document proposed that superannuation schemes should be entitled to imputation credits on the same basis as individual shareholders, in determining their tax liability. Bringing superannuation funds within the imputation system in this way was generally supported by submissions and is supported by the Committee. This aspect of the proposed taxation regime for superannuation is, in our view, critical. It will significantly reduce the tax impost which superannuation schemes face as a result of the proposed tax changes.

While critical to the operation of the taxation of superannuation funds, the impact of company imputation appears, on the basis of submissions received by the Committee, to be poorly understood. For example, the comments in the Consultative Document on the effect of full imputation were frequently disputed on the grounds that superannuation funds were already substantial equity investors. It did not appear to occur to those who argued

30/...

this point that they were stating that they had in the past been voluntary taxpayers, effectively paying tax at the corporate rate, and that the proposed superannuation tax changes would have a correspondingly reduced, and conceivably favourable, impact on their post-tax position.

4.1.4 Tax Rates

There is clearly no difficulty in determining the rate of tax which should be applicable to employee contributions to superannuation schemes: by definition, contributions made by employees are effectively taxed at their marginal tax rate.

As far as employer contributions are concerned, however, the tax rate applicable should be the effective marginal tax rate of the employee on whose behalf the contribution is made, and the same logic applies to the tax rate on fund income. The Consultative Document effectively recommended that both employer contributions and fund income should be taxed at the rate of 33%. A great many submissions objected to this, on the grounds that a majority of members of many schemes were taxed at a top marginal rate of less than 33%. On the whole, a 28% tax rate was seen as a reasonable approximation of the average marginal rate of scheme members (although many submissions argued for a 24% rate) and this rate was also seen as having the advantage of being equal to the company tax rate. The argument in the Consultative Document that a rate of 28%, or even 24%, would favour higher income earners was accepted, but it was strongly argued that attempting to impose the higher 33% rate would make superannuation schemes uncompetitive as a savings vehicle.

The Committee spent considerable time discussing this matter, and sets out the arguments for a 33% rate in Appendix 1.

On balance, the Committee was persuaded that applying a 33% rate, both to employer contributions and to scheme income, had some logical force, in a situation where, by definition, one single rate will be penal for some members and concessionary for others. On the other hand, the Committee was also persuaded that, in the interests of avoiding a major switch to unfunded superannuation schemes, the applicable rate should be 28%.

The Consultative Document suggested that the tax on employer contributions, and the tax on fund income, should initially be at a somewhat reduced level (25%) from the long-term desirable level. Evidence available to the Committee suggested that offering temporary concessions in this form would have little or no effect on the decision of employers

31/...

whether or not to wind-up superannuation schemes and, particularly in view of our recommendation that the long-term rates applicable should be 28% (the company tax rate) rather than 33%, we recommend that there be no concessionary regime after 1988/89.

The logic of a T/T/E regime is that all benefits paid by superannuation schemes, whether in lump sums or pension form, should be exempt from taxation. The Committee agrees with this conclusion.

4.1.5 Application of the National Superannuitant Surcharge

Logically, the National Superannuitant surcharge should not apply to benefits paid by superannuation schemes under a T/T/E regime, because the benefits paid by such schemes are not strictly income. On the other hand, scheme income should, logically, be subject to the surcharge. Because applying the surcharge to superannuation scheme income for those drawing National Superannuation would be complex, and perhaps almost impossible, the Consultative Document recommended a crude compromise, under which lump sum benefits would not be surchargeable, and pension benefits would be surchargeable at half the normal rate. The Committee came to the conclusion that this compromise should be retained if it is considered necessary to retain a surcharge on superannuation benefits.

The Committee considers, however, that there are good reasons for not applying the surcharge to superannuation benefits at all. While the proposal in the Consultative Document can be theoretically justified, it has the following practical disadvantages:

(a) it would add complexity to an aspect of the taxation system which is already too complex for the majority of taxpayers to understand and easily comply with;

(b) its rationale (that a proportion of benefits should be surcharged as a proxy for investment income derived by a superannuation fund and attributable to the National Superannuitant beneficiary) applies equally to lump sum benefits; and

(c) superannuation is only one of a number of ways in which it is possible to shelter income.

The Committee concluded, therefore, that retaining the National Superannuitant surcharge on pension superannuation benefits would, under a T/T/E regime, unfairly discriminate against this form of retirement provision and encourage people to take retirement benefits in other forms. We would prefer to see the surcharge removed from all superannuation benefits.

4.1.6 Relationship between a Taxed/Taxed/Exempt Regime and State Targeted Support Measures

One issue not considered in detail by the Consultative Document was how the proposed superannuation tax regime would interact with a number of income support measures which are targeted on the basis of household or individual income. The difficulty is that the abatement of these income support measures, as privately-derived income increases, can result in very high effective marginal tax rates for those recipients in the abatement range. These effective marginal rates can be substantially higher than the 28% tax rate recommended for employer contributions and fund income, and indeed can be higher than the 33% rate recommended in the Consultative Document. This raises the possibility of employers "washing" the remuneration of employees through superannuation schemes, to the significant benefit of those employees but to the impoverishment of the revenue authorities. Raising the rates at which employer contributions to superannuation schemes are taxed, and the rate at which superannuation scheme income is taxed, would create a significant incentive to provide unfunded superannuation, while low rates create the opportunity for significant abuse. Accordingly, the Committee recommends that an anti-abuse measure be enacted along the lines recommended in Appendix 1.

4.1.7. The Importance of Reducing Overall Tax Rates, and Harmonising Personal and Company Rates

The Committee is concerned that a 33% tax rate drives a very significant wedge between the pre-tax and post-tax return to savers. In our view the previous high top marginal tax rates were only possible because the lack of a comprehensive income tax base meant that such tax rates applied only in relatively few cases. High marginal tax rates were almost never applied to capital income. The Government's moves to strengthen the income tax system by making the tax base more comprehensive should reduce the extent to which the tax system has in the past distorted investment decisions. This can be expected to produce significant economic benefits.

At the same time it has created increased pressure on higher marginal tax rates, which are increasingly becoming effective tax rates for the upper income bracket and for those deriving capital income to a significant extent. Clearly, the reduction in the top marginal tax rate from 66% to 33% has greatly eased the pressure in this regard, but it seems doubtful whether even a 33% top rate is sustainable in the long-term.

33/...

These issues are brought into clear focus by the superannuation tax proposals. The proposals would remove a major tax concession, with an offsetting reduction in the tax rate. As indicated in the 17 December 1987 statement, it was originally envisaged that the applicable personal tax rate would be in the order of 22% to 25%. The subsequent increase in the 'top' tax rate to 33% has significantly increased the difficulty of implementing the Government's proposed superannuation measures. As an example of the impact of the higher tax rate, $100 pre-tax invested for 40 years at a pre-tax interest rate of 10% per annum would produce a capital sum of $12,383 at the end of the term under a 33% tax rate, but a sum at the end of the term of $19,172 under a 22% tax rate. In other words, the lower tax rate would result in the final capital sum being 55% higher.

The problems created by having a corporate tax rate which is significantly different from the top personal tax rate are numerous, and create a very significant incentive for many individuals to shelter their income within company structures. In the context of superannuation, the difference between the company rate and the top personal marginal rate is directly responsible for producing a situation where, no matter what rate is chosen for taxing employer contributions and superannuation scheme income, it is incorrect: if the rate chosen is the company rate, 28%, it is concessionary to high income individuals. If the rate chosen is 33%, there is a marked incentive for companies to provide unfunded superannuation schemes, with resultant adverse impact on capital markets, and on the security of the provision of private retirement income.

The Committee therefore believes that the Government should seriously consider aligning the company tax rate and the top personal tax rate, preferably at or somewhat below 28%.

4.2 Key Features of an Exempt/Taxed/Taxed Regime

As argued in Chapter 3, the Committee recommends that Government gives serious consideration to adopting a modified E/T/T regime for retirement income funds for the 1989/90 financial year, and subsequently. As explained, this involves the deductibility of contributions made by both employers and employees, tax on fund income, and tax on benefits, but with a tax-free lump sum up to a maximum of 25% of the benefits (subject to a limit) to offset the disincentive effect of the National Superannuitant surcharge.

4.2.1 Proposed Limit on the Deductibility of Contributions

Because an E/T/T regime is not, in itself, a concessionary regime, it should not be necessary to limit the extent of deductibility of contributions to any scheme established under an E/T/T regime. After due consideration, however,

the Committee came to the conclusion that there should be a limit on the deductibility of contributions, and proposes that that limit be equal to 20% of the contributor's taxable income (that limit to include both employee and employer contributions). This limit would both reduce the scope for the use of income sheltering mechanisms, and would assist the Government in forecasting its revenue.

It may well be that a limit of 20% is too low, and may have to be adjusted in due course. Our advice is that the standard in the industry for large superannuation schemes is the Government Superannuation Fund. In order to provide a satisfactory pension level, a total contribution of between 16% and 20% of salary is required in terms of the tax regime prevailing before 17 December 1987. The level will need to be higher under either an E/T/T or a T/T/E regime, because of the proposal to tax fund income.

Limiting the deductibility of contributions to superannuation schemes to 20% of an individual's taxable income creates certain practical difficulties. For example, if the combined contributions of employer and employee exceed 20%, which party should enjoy the benefit of deductibility? On balance, it is recommended that the employer has first "call" on the 20% limit on deductibility, with any "excess" being available to the individual member. This is recommended in part for practical compliance reasons, and in part because the employer contribution is typically rather greater than that of the employee.

But if the employer has first "call" on the limit on deductibility, this creates an unfair situation where an employee is obliged to belong to a defined benefit scheme at his place of employment, where the employer "uses up" a large part, conceivably all, of the 20% limit on deductibility, and where the terms of the superannuation scheme provide for vesting only a small part of the employer's contributions if the employee leaves the place of employment before a lengthy period. On balance, the Committee recommends that, in the case of any compulsory superannuation scheme, a condition of scheme registration should be an obligation to vest 100% of employer contributions for the benefit of withdrawing members. There need be no such mandatory vesting in the case of superannuation schemes joined voluntarily.

As far as contributions made in excess of the 20% limit are concerned, these would be made from tax-paid income on the part of individual contributors, but would be deductible to employers and subject to FBT.

35/...

Later in this chapter it is noted that, to avoid any element of retrospectivity in the introduction of this new regime, it would be necessary to allow some benefits to be withdrawn from existing superannuation schemes without incurring tax. We also noted in Chapter 3 that there is a sound case for allowing up to 25% of scheme benefits to be paid in a tax-free form if benefits are taken after eligibility for National Superannuation. To prevent abuse, it would be necessary to provide that neither an individual nor a related employer would be allowed to make any deduction for a contribution to a superannuation scheme in respect of that individual for three income years from the end of an income year in which that individual received any tax-free benefit from a superannuation scheme.

4.2.2 Tax on Fund Income in an Exempt/Taxed/Taxed Regime

As with a T/T/E regime, we see the need to tax fund income as a proxy for fund members under an E/T/T regime. As with a T/T/E regime, therefore, we see no reason to tax capital gains realised by a RIF, we see scheme income being taxed at 28% after 1988/89, and we see no reason for any temporary concession such as that suggested by the Consultative Document beyond the present year.

Paradoxically, however, the treatment of non-investment expenses should be different under an E/T/T regime from that under a T/T/E regime. In a situation where contributions to a RIF are deductible, allowing non-investment expenses to be deductible also effectively allows for a double deduction. On the other hand, we were eventually persuaded that denying the deductibility of such expenses could effectively be circumvented in many cases, and in these circumstances we believe that it would be simplest to allow the deductibility of non-investment expenses in this regime also.

4.2.3 The Taxation of Benefits from RIFs

Because we see the proposed departure from a normal income tax regime as justified only because of the desirability of encouraging the private provision of retirement income, 75% of the benefits of a RIF regime would be required to be paid out in pension form, with no more than 25% of the balance available to be paid out in lump sum form. These benefits could be paid out at any time, and in principle both lump sum and pension would be liable to tax, and to the National Superannuitant surcharge.

In the modified E/T/T regime which we are recommending for consideration by Government, the 25% lump sum would be exempt from tax up to a limit (suggested to be set at $75,000 initially), if benefits were taken after eligibility for National Superannuation. As explained in Chapter 3, the

36/...

logic of this is that the exemption of tax on the lump sum would be calculated to be approximately equal to the surcharge on the remaining pension, thus offsetting the disincentive effect of the surcharge on the private provision of retirement income.

4.2.4 Transition to Modified Exempt/Taxed/Taxed Regime

While the Committee was persuaded of the logic of applying an E/T/T regime to pension schemes, we had considerable difficulty trying to decide how to deal with the present right in many pension schemes for members to withdraw all benefits, in lump sum form free from tax, prior to age 50, and of the right to wind-up schemes even beyond age 50, and receive an amount related to the member's own contributions without incurring tax. It was initially suggested that these rights should simply be withdrawn. It is in this area, after all, that much of the "abuse" of the concessionary tax regime takes place, with contributions deductible, fund income exempt from tax, and benefits able to be withdrawn, in full prior to age 50, without the imposition of tax. Such withdrawal rights hardly appear consistent with a concessionary tax regime ostensibly designed to encourage the private provision of retirement income.

But suddenly removing these rights could seriously jeopardise the financial plans of many people, and on balance the Committee felt that this would be excessively harsh.

On the other hand, retaining these rights while moving to tax fund income would create a very considerable incentive to withdraw from a pension scheme before age 50, and indeed an incentive to wind-up many schemes - precisely the action which the Committee seeks to avoid.

We eventually concluded that all pension schemes should determine on behalf of their contributors the amount which those contributors would receive on a tax-exempt basis if the scheme were wound up as at 30 June 1988. This dollar amount would be recorded as the amount up to which contributors could receive a tax-free lump sum at whatever point they retire/withdraw from the scheme, or the scheme is wound up, notwithstanding the application of the "25% rule" to the payment of all other retirement benefits.

This approach has the advantage of removing any element of retrospectivity with respect to the rights of contributors to withdraw from pension schemes, and to eliminate any incentive to withdraw immediately, or wind-up schemes, if that right is retained.

Such a transitional regime would have the disadvantage from Government's point of view of foregoing all revenue on the payment of retirement benefits up to a substantial part of the assets of pension schemes on 30 June 1988. From a revenue point of view, therefore, this proposal is generous to contributors. At the same time, it would still yield revenue in excess of the T/T/E alternative, by subjecting to tax benefits arising from amounts in excess of the tax-free amounts standing to the credit of those aged 50 or more on 30 June 1988.

4.3 Re-negotiation of Superannuation Schemes

The most significant change in the income tax regime for superannuation schemes proposed by the Consultative Document was the introduction of taxation on fund income. Although the Committee has made a number of recommendations about the basis on which fund income should be taxed, and the rate at which it should be taxed, we have no quarrel with the basic proposal to tax such income. To date, the income of most superannuation schemes has been exempt from tax. The effect of the introduction of tax upon fund income will be to reduce the amount of money in the fund from which contracted benefits can be paid. Accordingly, contributions and/or benefits will need to be adjusted to reflect this new reality.

The Consultative Document proposed that approved superannuation schemes should be required to secure the agreement of a majority of scheme participants to the re-negotiated terms of a superannuation scheme, and to lodge that agreement with the Government Actuary by 1 July 1989.

This proposal drew a large number of submissions. Essentially, two points were made in most such submissions. First, there was a widespread scepticism about the feasibility of getting the agreement of fund members to the changes which would be required by proposed taxation changes. Some submissions were concerned principally about the sheer logistics of securing such agreement, in schemes where there are many thousands of members, scattered widely throughout New Zealand (and indeed abroad). Others felt that the interests of members of different ages would be so divergent as to make agreement virtually impossible. On balance, the Committee was persuaded that it is not practical for the trustees of most superannuation schemes to obtain the approval of the majority of members to what is, after all, a reduction in the expectations which they had when they entered the scheme. We recommend that the trustees of superannuation schemes should be empowered to determine new benefit levels, in accordance with guidelines issued by the Government Actuary, and subject to the approval of the Government Actuary.

38/...

Secondly, given the very large number of schemes which must now be modified, we were also persuaded that the deadline proposed in the Consultative Document of 1 July 1989 was quite unrealistic, and we propose instead a deadline of 31 March 1990.

4.4 Registration and Regulation

The present regulatory system for superannuation schemes is contained in the Superannuation Schemes Act 1976 and the Superannuation Schemes Regulations 1983. The Committee spent some time discussing whether there was in fact a need for regulation at all and, if so, whether the existing legislative and regulatory framework was adequate.

On balance, our view is that it is in fact necessary to have some form of regulation of superannuation, both to limit the scope for abuse of the tax system (largely arising from the differential rate structures for individuals and companies) and to provide some form of prudential supervision of the retirement savings funds of large numbers of individuals.

We see the required framework being essentially the same for schemes established under a T/T/E regime and for those established under any possible E/T/T regime. Essentially, the framework we propose would have the following features:

(a) a single Act to cover both retirement income funds and retirement lump sum funds, to be known as the Retirement Funds Act (a draft of which is attached as Appendix 5);

(b) a standard form of trust deed for all registered retirement income funds and retirement lump sum funds, which deed would be mandatory for all funds registered under the Retirement Funds Act, save where the Government Actuary specifically permits. We see this proposal as highly desirable in the interests of economising on the expensive resources currently devoted by employers trying to outwit the Government Actuary, and by the Government Actuary trying to avoid being outwitted;

(c) a new prudential role for the Government Actuary to assist in the protection of the interests of scheme members;

(d) a requirement on all registered schemes to report regular and audited financial information to all scheme members;

39/...

(e) a requirement that at least one trustee of each retirement fund should be a fund member;

(f) a requirement that all investments by a registered scheme be on a fully arm's length basis;

(g) a requirement that there be a specific limit on the amounts that can be invested in a contributing employer or member; and

(h) granting of interim registration for all schemes currently approved by the Government Actuary to last until 31 March 1990. This would give an opportunity for such existing schemes to adopt the new standard form of trust deed, and to re-negotiate their scheme benefits prior to 31 March 1990.

As indicated, all of the above regulatory features would be common to both a T/T/E regime and an E/T/T regime. Only one additional restriction would be required for an E/T/T regime, and that relates to the prohibition on mixing the funds of schemes established under an E/T/T regime with other types of funds. This would in no way restrict any institution or company from establishing a scheme under the proposed E/T/T regime. We explicitly recognise that these schemes could be established by life insurance companies, banks, building societies, or any other institution or company. Indeed, an individual could operate his or her own RIF scheme under the E/T/T regime.

19/6/88

APPENDIX 1 - TAXATION UNDER TAXED/TAXED/EXEMPT

A1.1 Introduction

A1.1.1 Purpose of the Appendix

This appendix sets out the recommended tax treatment of superannuation fund contributions, fund earnings and benefits under a T/T/E regime.

A1.1.2 Outline and Summary of the Appendix

This Appendix outlines our detailed recommendations on the operation of the taxation aspects of the T/T/E regime recommended by the CD. Re-negotiations of schemes is considered in Appendix 3, and the regulatory regime in Appendices 4 and 5.

Our main recommendations can be summarised as follows:

a FBT on employer contributions should be replaced by a final withholding tax;

b schemes should be entitled to full deductibility of expenses and should not be subject to special rules making them taxable on realised capital gains;

c the tax rate on employer contributions and schemes investment income should be 28%; and

d pension benefits should not be subject to National Superannuitant Surcharge.

A1.2 Definition of Superannuation

A1.2.1 The Need for a Definition of Superannuation

Superannuation needs to be defined so as to establish the ambit of the superannuation tax rules. This was an issue not fully addressed in the CD which focussed on the definition of a registered superannuation scheme. The ambit of the tax rules applying to registered superannuation schemes will be determined by the requirements of registration. That is considered in Appendix 4. However, special rules will also apply to unregistered schemes. In particular, as discussed below, it is considered necessary to maintain restrictions on an employer's ability to deduct contributions to such schemes. Thus, the general definition of superannuation is important in determining what will be an unregistered scheme and thus when special tax rules should apply.

A1.2.2 Existing Definitions

Section 2 of the Superannuation Schemes Act 1976 defines a superannuation scheme as including:

> "any scheme, fund, or plan for providing retirement and other benefits for employees or other persons or their dependents, whether at or after the retirement or death of the employees or persons or during their service, and whether by means of life insurance or otherwise."

Section 2 of the Income Tax Act essentially divides superannuation funds into those which have been approved by the Government Actuary and those which have not been so approved. A non-approved superannuation scheme is effectively defined by that section as any scheme or fund established for the purposes of providing benefits which consist principally of superannuation, pension, or other retirement benefits, being a scheme or fund which has not been approved by the Government Actuary.

For the purpose of denying deductions for employer contributions, section 106(1)(m) of the Income Tax Act effectively defines a superannuation scheme to be any scheme or fund established for any purposes which includes the purpose of providing for any person benefits which consist principally of superannuation, pension, or other retirement benefits.

A1.2.3 Comment

It is apparent that the current definitions of what constitutes a superannuation scheme vary. This can cause confusion and give rise to unintended results. We support a definition of what constitutes superannuation which is consistently applied in income tax and superannuation legislation.

We consider that a superannuation scheme should be restricted to entities providing retirement and similar benefits on the cessation of the employment of a natural person. The provision of such benefits is the critical feature distinguishing superannuation from other forms of saving.

We also consider that a superannuation scheme should be defined so as to be restricted to legal entities distinct from contributor(s) and beneficiaries. It is possible to have a superannuation-type arrangement where there is no distinct legal entity acting as an intermediary between contributors and beneficiaries. An example is where an employer promises to pay directly to employees a sum of money on the occasion of their retirement. This can be viewed as a form of unfunded superannuation scheme.

However, the Committee is of the view that such arrangements should not be included within any superannuation tax or regulatory regime. Normal tax rules can and should apply in such a case. Since the payment flows directly from the employer to the employee, it can and should be treated as

assessable income of the employee. This is subject only to any special legislative rules which Parliament may wish to enact. An example is the special rules on lump sum retirement allowances which are currently contained in section 68 of the Income Tax Act, which the Income Tax (No. 4) Bill 1988 proposes to amend.

On the other hand, a superannuation scheme can still operate through a separate legal entity and be unfunded or partially funded. An example is where a separate superannuation scheme is established to provide employees with a retirement allowance but the employer pays money into the fund only at the time the fund needs cash to pay benefits out to retiring or retired members. Such a superannuation scheme, as a separate legal entity, should come within the superannuation definition.

With respect to New Zealand resident superannuation funds, we consider that to fall within the definition of superannuation, the scheme should be established in the form of a trust. Other legal entities, such as companies, should be taxed under their appropriate taxation regime. With respect to non-resident funds, restricting the regime to trusts seems less appropriate given the wide variety of entities available in different jurisdictions.

A1.2.4 Recommendation

It is recommended that:

(a) a consistent definition of superannuation be adopted for the purposes of both income tax and regulatory legislation; and

(b) a superannuation scheme be defined as:

any New Zealand resident trust established by its trust deed principally for the purpose of providing retirement benefits to beneficiaries who are natural persons; or

any non-resident legal entity established principally for the same purpose.

Minister's decision: Agreed.

A1.3 Member Contributions

A1.3.1 Previous Position

A scheme member was able to deduct from assessable income contributions to a subsidised employee superannuation scheme up to a maximum of $1,200 per annum. A member of a personal scheme could deduct from assessable income contributions to a pension scheme, or to an approved lump sum scheme if a member

prior to the 1984 Budget. The maximum deduction was $1400 per annum. (Section 59 of the Income Tax Act 1976 refers)

A1.3.2 Consultative Document

The CD stated that the deduction which has been available for member contributions to superannuation would be withdrawn. (Volume 1, paragraph 6.3)

A1.3.3 Changes Already Made

The Income Tax Amendment (No. 2) Act 1988 has already implemented this proposal. Contributions made on or after 17 December 1987 - the date the proposed changes were announced - no longer qualify for the exemption.

A1.3.4 Comment

Withdrawal of the taxation exemption for member contributions is consistent with a T/T/E regime.

A1.3.4 Recommendation

We recommend the removal of the member contribution exemption under a T/T/E regime.

Minister's decision: Agreed.

A1.4 Employer Contributions

A1.4.1 Previous Position

Employer contributions to a superannuation scheme have been non-deductible under section 106(1)(m) of the Act except to the extent that those contributions have qualified for deductibility under section 150 of the Act. Broadly, this section allowed deductions for employer contributions to approved employee schemes up to the maximum of the smaller of:

- the amount the employer was required to contribute;
- 10 per cent of the assessable remuneration of scheme members.

A further restriction on the deductibility of employer superannuation contributions has applied with respect to shareholder employees. The position of shareholder employees is considered separately below at A1.5.

Despite these restrictions, it has generally been true that employer superannuation contributions have been deductible to the employer. They have (also generally) not been either assessable to the scheme or employee nor subject to FBT. The Act has specifically exempted superannuation schemes from tax on contributions (sections 61(21) and 225(4)(b) of the Act)

and employer contributions have been specifically exempted from FBT (section 336N(1) of the Act). Thus in most cases employer contributions have been deductible to the employer, non-assessable and exempt from FBT.

A1.4.2 The Consultative Document

As noted by the CD, exempting employer contributions from taxation is inconsistent with the adoption of a T/T/E regime for superannuation (paragraph 6.4 of Volume 1). Under a T/T/E regime employer contributions should be taxed. The CD identified three options for taxing employer contributions:

a tax contributions as employee income; or

b tax the superannuation scheme; or

c subject contributions to FBT.

An additional option would have been to deny the employer a deduction for contributions. Denying a deduction for employer contributions while leaving contributions tax-free would favour those employers who are in tax-loss or who are tax-exempt. For that reason the CD favoured allowing employer contributions to be fully deductible to a registered superannuation scheme but to make them taxable.

With respect to deductibility, it supported removing:

i the constraints on the quantum of contributions which employers can make; and

ii the discretion which the Commissioner has under section 150(6) of the Act to deny deductions.

The CD also made recommendations concerning clawbacks and shareholder employees which are considered below at A1.10 and A1.5 respectively.

With respect to ensuring that contributions were taxable, the CD rejected option (a) - taxing scheme members - as being impractical. Of the remaining two options it identified, it supported taxing employer contributions by subjecting them to FBT. The stated reason for doing so was that this "would be likely to incur the lower administrative and compliance costs." The CD proposed that FBT be levied on all employer superannuation contributions - whether or not made to a registered scheme. It proposed that FBT liability attach to any payment made by an employer to a superannuation fund for the benefit of an employee and that it should also attach to scheme management and administrative expenses which are met directly by the employer.

A1.4.3 Changes Already Made

The decision to subject employer superannuation contributions to FBT was implemented by the Income Tax Amendment (No. 2) Act 1988. Any employer contribution made on or after 17 December 1987 to an approved superannuation scheme is now a specific category of fringe benefit, the taxable value of which is "the amount of contributions made by the employer" (section 336O(3B)). The previous fringe benefit exemption for employer superannuation contributions has been repealed. Employer contributions to non-approved schemes remain, as under previous law, subject to normal FBT provisions. No specific legislation has been enacted to include scheme expenses directly incurred by employers as a taxable fringe benefit. With respect to the restrictions on the ability to deduct employer contributions, section 150(4) of the Act (which was concerned with shareholder-employees) has been repealed - the position of shareholder-employees is considered separately below. Other restrictions on the deductibility of employer contributions remain in place.

A1.4.4 General Comment

We agree that, under a T/T/E regime, employer superannuation contributions to a registered superannuation scheme should be fully deductible to the employer but taxable at a rate which reflects as closely as possible the tax rate of benefitting employees.

Details on the operation of such a regime are considered in the following paragraphs:

A1.4.5 Deductibility of Employer Contributions

We note first that existing law has been aimed at preventing employers from taking a deduction for superannuation contribution liabilities which have accrued but which have not been extinguished by the payment of funds to the superannuation scheme. This is reflected in the CD which states that since such accrued liabilities are difficult to tax, deductions for employer contributions will be denied.

While the intention of existing law may have been to deny deductions for these 'unfunded' superannuation liabilities, there has been at least some ambiguity on this point. This is because the general prohibition on the deductibility of employer superannuation contributions, section 106(1)(m) of the Act, is worded in terms of "any expenditure by way of contributions". To institute a T/T/E regime, we consider that there should be a general section barring deductions for employer contributions unless otherwise provided for in the Act. This general prohibition section would be along the lines of section 106(1)(m), but the section should be amended to deny deductions for expenditure incurred with respect to superannuation contributions payable in any income year. That

would make it clear that the section denies deductions for accrued superannuation liabilities such as liabilities under an unfunded or partly-funded superannuation scheme.

The Act should then provide that deductions will be allowed for amounts paid by way of superannuation contributions to any registered superannuation scheme. Deductible contributions should be defined as amounts in money or money's worth paid or credited to a registered superannuation fund within the income year. This would not allow a deduction for amounts unpaid but still incurred in that income year. To allow some relief in this regard, it is recommended that amounts paid or credited within 63 days of the end of the employer's income year will be deductible in the preceding income year provided the liability to pay was incurred in that preceding income year.

We agree with the CD that the limitation on the quantum of employer contributions and the section 150(6) discretion to deny deductions vested with the Commissioner should be repealed. The general rules on deductibility would then be that amounts paid by an employer as contributions to a registered superannuation scheme would be deductible without limit, but that contributions to non-registered schemes and accrued contributions would be non-deductible.

Most of the submissions we received on this point concerned either the timing of the removal of deductibility restrictions or the position of shareholder-employees. The latter point is considered separately below. We consider that deductibility restrictions should be removed from the same date as pensions become tax-free under a T/T/E regime - 1 April 1989.

A1.4.6 Taxing Employer Contributions - The Options

We received a number of submissions discussing the preferred means of taxing employer contributions. All agreed that it would be impractical to attribute employer superannuation contributions to individual scheme members and levy tax on that basis. However, it was strongly argued that of the other two options identified by the CD - FBT or taxing employer contributions as fund income - the latter would more efficiently meet the Government's objectives.

We found the arguments in favour of taxing employer contributions in the hands of the superannuation fund to be persuasive. On the basis of the submissions we received, we have concluded that levying FBT would create unnecessary compliance costs for many employers who, since they do not provide their employees with any other form of fringe benefit, have been exempted from the requirement to file quarterly fringe benefit returns. Moreover, the incidence of the tax burden is more likely to be substantially borne by employers, at least in the short term, if tax is collected through the FBT system. Both of these factors would seem likely to lead a number of employers to cease making superannuation

contributions and to close down their employee superannuation schemes when, if the same tax were levied directly on the scheme, this would not necessarily happen.

The main reason advanced for not levying tax on employer contributions at the superannuation fund level was the possible difficulty for a superannuation scheme and the revenue authorities in differentiating between those contributions which would not constitute assessable income of the fund (member contributions), and employer contributions which would constitute fund assessable income. However, a method for implementing a system under which employer contributions are assessable income of the superannuation fund is outlined in the section on mechanics below. We consider this to meet the compliance requirements of both superannuation funds and the revenue authorities.

A1.4.7 Mechanics of Taxinq Employer Contributions

It is recommended that employer contributions should be subject to a final withholding tax at a 28% rate payable by the employer along with monthly PAYE deductions. This should apply from 1 April 1989. Administratively it would not be possible to implement this change before that date. Therefore FBT payments must be made to cover the period from 17 December 1987 to the quarter ending 1 April 1989 as provided for in existing legislation. The justification for the 28% rate is covered below.

Employer contributions to non-registered schemes will remain subject to FBT and non-assessable in the hands of the superannuation fund.

A1.4.8 What is to be Taxed as an Employer Contribution?

Employer contributions subject to tax in the hands of the fund (or, as the case may be, subject to FBT) will include all contributions to a superannuation fund.

If payments are made by the employer directly to the employee, under the definition of superannuation scheme previously proposed, the superannuation taxation provisions will have no application and normal income tax rules will apply.

However, this leaves open the relationship between sections 75 and 96 of the Act and the superannuation provisions. The relationship between these sections and the superannuation taxation regime has never been entirely clear.

Section 75(1) of the Income Tax Act provides that a person is deemed to derive income even if it is not paid to or received or receivable by him if the income is, inter alia, credited in account, accumulated or otherwise dealt with in his interest or on his behalf. The section has been invoked to bring within an employee's income compulsory member superannuation

contributions. It is arguable that it could also be invoked in some circumstances to bring within an employee's income employer contributions.

That would be contrary to the intent of the superannuation taxation provisions. We recommend that section 75(1) be explicitly made not to apply so as to deem employer superannuation contributions to be income of the employee.

Section 96 of the Income Tax Act is a complicated and in many ways a rather obscure provision of the Act. Very broadly, it provides that where:

- a person transfers to another person any asset or right to income
- for a period which may be less than, in general, seven years,
- and the property transferred remains under the control of or can revert to the transferor, a relative of the transferor or company in which either has an interest,

then the income of the person to whom the property or right to income is transferred is deemed to be derived by the transferor.

Section 96 is poorly drafted and has a possible wide application with, in some cases, perverse results. It may be possible to apply it in some circumstances where assets are transferred to a superannuation scheme as either employee or employer contributions.

In general, we consider that the section should be reviewed and should be focused more clearly on any current policy concerns. Nevertheless the supposed mischief to which the section applies could be present where the recipient entity is a superannuation scheme to an equal extent as any other entity. We therefore do not recommend that section 96 should be amended so as to exclude its application to superannuation schemes.

Nevertheless, section 96 should be amended to exclude its application to superannuation schemes where the minimum period for holding the transferred asset or right to income could be breached only on the grounds of the retirement or cessation of current employment of a scheme member.

A1.4.9 Definition of Taxable Employer Contributions

A major concern raised in submissions was the statement in the CD that superannuation scheme expenses met directly by the employer will constitute a taxable fringe benefit. This is seen as being impractical to administer given the difficulties of quantifying many of the costs which employers incur on

behalf of schemes. For instance, one submission gave the example of a senior executive who spent some of his or her time as an unpaid trustee of the firm's superannuation scheme. Part of that senior executive's salary is an indirect contribution to the superannuation fund, but the amount of that contribution would be difficult and costly to quantify. Presumably for similar compliance reasons, the Income Tax Act currently provides an exemption from fringe benefit tax for any benefit that is provided by an employer on its own premises where the benefit is enjoyed by the employee on those premises (section 336N(1) definition of fringe benefit paragraph (n)).

As pointed out to us, a related problem with this proposal is that there are occasions when an employer will incur expenditure which will be for the benefit of both the employer and the superannuation fund. An example given was the carrying out of an actuarial valuation of a defined benefit plan which the employer required in order to assess its liabilities but which was also of value to the scheme trustees.

We agree with the principle that contributions in kind should be taxed to the same extent as contributions in cash form. This is after all the rationale behind the fringe benefit tax regime and indeed the proposal to tax employer superannuation contributions. It is also desirable to ensure that superannuation schemes, the expenses of which are met by employers, are taxed comparably with those schemes which meet all their own expenses. However, as in all areas of tax policy, these principles need to be balanced by the requirements of a workable tax regime which keeps compliance costs as low as possible. In addition, the appropriate tax treatment of employer-paid expenses is to some extent dependent on the ability of the scheme to deduct expenses it incurs directly - this issue is addressed in section A1.6.3.

Bearing these factors in mind, we have concluded that for the purpose of taxing employer contributions, contributions should be defined in the same terms as recommended with respect to the deductibility of those contributions - as amounts in money or money's worth paid or credited to a superannuation fund. Other benefits provided by an employer to a scheme should be subject to FBT unless the benefit is provided on the employer's premises or unless that expenditure would be deductible to the scheme.

A1.4.10 Recommendations

It is recommended that under a T/T/E regime:

a the section 106(1)(m) general bar on the deductibility of superannuation contributions should be extended to

prevent deductions for contributions payable in any income year;

Minister's decision: Agreed.

b the Act should then provide that deductions will be allowed for amounts paid by way of superannuation contributions to any registered superannuation scheme. Deductible contributions should be defined as amounts in money or money's worth paid or credited to a registered superannuation fund but should also include amounts incurred within an income year and paid as aforesaid within 63 days of the end of the employer's income year;

Minister's decision: Agreed.

c the limitation on the quantum of employer contributions and the section 150(6) discretion to deny deductions vested with the Commissioner should be repealed with effect from 1 April 1989;

Minister's decision: Agreed.

d employer contributions to a registered superannuation scheme should be taxable as a final withholding tax as from 1 April 1989 and be exempt from FBT. This tax should be a liability of employers along the same lines as PAYE payments;

Minister's decision: Agreed.

e employer contributions to other schemes and benefits provided to registered superannuation schemes other than by way of contributions should be subject to FBT unless the benefits are provided on the employer's premises or the benefits would be deductible expenditure of the superannuation fund;

Minister's decision: Agreed.

f employer contributions to a superannuation fund should be defined as amounts in money and money's worth paid or credited to a superannuation fund;

Minister's decision: Agreed.

g section 75(1) of the Income Tax Act should be clarified so as not to deem employer superannuation contributions to be income of the employee; and

Minister's decision: Agreed.

h **section 96 should be amended to exclude its application to superannuation schemes where the minimum period for holding the transferred asset or right to income could be breached only on the grounds of the retirement or cessation of current employment of a scheme member.**

Minister's decision: Agreed.

A1.5 Shareholder-employees

A1.5.1 Previous Position

Under previous law there were two restrictions on the deductibility of employer superannuation contributions with respect to shareholder-employees. First, to be an approved employee scheme (so that contributions are deductible and investment income exempt) no scheme member could own 50 percent or more of an employing company. Secondly, the Commissioner has had a discretion under section 150(4) of the Act to deny deductions in respect of contributions for an employee owning 20 percent or more of an employing company.

Section 4(2) of the Act deems any non-deductible expenditure of a "proprietary company" (a company controlled by 4 or fewer persons), the benefit of which is enjoyed by a shareholder, to be a dividend assessable in the hands of the shareholder. Thus, if a proprietary company made superannuation contributions for the benefit of any shareholder, and those contributions were non-deductible under section 150(4) (because they were in respect of an employee owning 20 per cent of the company), then the contributions as well as being non-deductible could be deemed to be assessable to the employee as dividends under section 4(2).

A1.5.2 The Consultative Document

The CD stated that the preferred approach to superannuation contributions for shareholder-employees was to remove all restrictions on deductibility. However, it further noted that this raised the question of how proprietary company dividends and shareholder-employees are to be treated in future, an issue discussed in the CD on Full Imputation. It was stated that this issue would be addressed in the light of decisions on the general tax treatment of proprietary companies and shareholder-employees.

A1.5.3 Changes Made

The Income Tax Amendment (No. 2) Act 1988 has already enacted changes in this area. Section 150(4) which provided the Commissioner with the discretion to disallow deductions for contributions in respect of shareholder-employees owning more than 20 per cent of the employing company has been repealed. Instead, the Income Tax Act now provides that employer

superannuation contributions made on or after 1 April 1988 with respect to "major shareholders" are non-deductible. Broadly, a "major shareholder" is a person owning 10 per cent or more of a private company (section 336N(1) of the Act). Such benefits are not subject to FBT - benefits of any kind provided to major shareholders are exempt FBT - but, since the expenditure is non-deductible, they may be assessable as dividends under section 4(2) of the Act.

A1.5.4 Comment

For those employees owning over 20 per cent of the employing company, these legislative changes have not altered their taxation position. Superannuation contributions for their benefit remain non-deductible, exempt FBT, but possibly assessable as a dividend.

This particular change in the legislation has not affected those owning less than 10 per cent of the employing company.

However, those owning between 10 and 20 per cent of the employing company have been adversely affected. Previously superannuation contributions for their benefit were deductible, non-assessable and exempt FBT. The CD suggested that the contributions would remain deductible but be subject to FBT. The legislation in the Income Tax Amendment (No. 2) Act 1988 has instead removed deductibility and in many cases made the contributions assessable as dividends. Instead of moving from a deductible/non-assessable regime to a deductible/assessable regime, they have moved from a deductible/non-assessable regime to a non-deductible/ assessable regime. As pointed out in submissions, this affects a number of superannuation schemes established for professional groups with the approval of the Commissioner of Inland Revenue.

We appreciate the reasons why the legislation was amended in this way. The Government wanted to make employer superannuation contributions deductible but subject to FBT along the lines suggested in the CD. However, major shareholder employees have a general FBT exemption and it was desirable to retain this exemption until the area was reviewed by the Consultative Committee on Full Imputation. On the other hand, to leave the major-shareholder FBT exemption in place and the deductibility for superannuation contributions for the benefit of the 10 to 20 per cent major shareholders would have placed those individuals at a considerable advantage relative to all other taxpayers. Instead, however, these taxpayers have now been put at a considerable disadvantage relative to other taxpayers.

The Consultative Document on Full Imputation suggested that remuneration of major-shareholder employees should, under an imputation system, be taxed in the same way as the remuneration of other employees. With respect to superannuation, we agree. We recommend accordingly that the special restrictions on the deductibility of superannuation contributions for their benefit be removed **with effect from 1 April 1988** and that those contributions should be assessable (in the hands of the superannuation scheme or under FBT as the case may be) as for any other employer superannuation contributions.

A1.5.5 Recommendation

> **It is recommended that employer superannuation contributions for the benefit of all shareholder employees be deductible on the same basis as other employer contributions with effect from 1 April 1988.**

Minister's decision: Agreed.

A1.6 Superannuation Fund Net Investment Income

A1.6.1 The Proxy Concept

The CD proposed that superannuation funds be taxed as a proxy for the tax which should be paid by the scheme members. This is the concept employed in the existing tax treatment of life offices and those (Class B and non-approved) superannuation schemes which have in the past been taxable.

If investment income is to be taxed, the submissions we received were generally supportive of the use of the proxy concept and the taxing of investment income in the hands of the scheme. The purer tax system would quite clearly be to attribute investment income to individual scheme members and tax those individuals on their attributed portion of income. As noted below in the discussion of tax rates, the proxy approach to taxing net investment income necessarily involves some distortions given that the circumstances of individual scheme members will differ. However, we are in agreement with the CD and those submissions we received on this issue that the proxy system is the only workable method of taxing superannuation schemes.

A1.6.2 Taxable Revenue and Capital Gains

Under the proxy concept, a superannuation scheme is essentially taxed as if it were one of the individual scheme members. Thus a superannuation scheme should be taxable on all its income as if it were a natural person. A superannuation scheme should therefore be taxable on dividends (subject to imputation as discussed below), rents, and any income from a financial arrangement as determined by the

accrual rules. Restricting the taxation of superannuation to a proxy tax should also mean that the scheme should not be taxed on member contributions.

The CD proposed exceptions to this general rule. The exception which was most commented upon by submissions was the CD's proposal that superannuation schemes include in assessable income any profit or loss from the disposal of any of the scheme's investments. In other words, the CD supported levying a realised capital gains tax on superannuation schemes. The CD justified this approach first on the basis that it would be consistent with the current taxation treatment of other "financial institutions" such as banks, life offices and general insurers. Secondly, taxing superannuation schemes on realised capital gains was argued to be consistent with the proposal (set out in the Consultative Document on Full Imputation) to continue to tax dividends paid out of capital profits.

The contrary argument put to us by submissions was that if superannuation scheme members invested directly rather than through a superannuation scheme they would not be liable to tax on realised capital gains. Such a tax would therefore act as a penalty on those who save through superannuation schemes.

We see force in both of these arguments. Existing law on the taxation of so-called 'capital gains' lacks clarity and rationality. The distinction between a non-taxable capital gain and taxable income is a confused mixture of judicial interpretations of the capital/income distinction (this is the basis for the law that any gain made by certain financial institutions on the sale of investments is taxable income) and specific statutory provisions (such as the detailed rules in section 67 of the Act on the taxation of gains from certain land transactions).

Recent taxation reforms implemented by New Zealand have seen a dilution of the capital/income distinction. A notable example is the accrual rules which have brought into the taxable income category many forms of gains which were previously considered to be non-taxable capital receipts. More recently, the Government has indicated its intention to pursue the possibility of taxing capital gains across the board in a consistent manner. This has received the firm endorsement of the Consultative Committee on International Tax Reform and Full Imputation. That Committee has stated that "the next step in the Government's tax reform programme should be to extend the tax base to include capital gains as soon as it is feasible to do so with the objective of facilitating a further reduction in tax rates."

We broadly share the views of the Consultative Committee on International Tax Reform and Full Imputation that an extension of the tax base to include capital gains would be consistent with the Government's general tax reform programme and with the tax reforms being implemented by other western countries. We reiterate our previous comment that existing taxation law in this area lacks clarity and rationality.

Thus taxing realised investment gains made by superannuation funds could be justified on the basis that this would be consistent with the desirable direction of future taxation reform. However, in our view, a general extension of the tax base to include capital gains would not necessarily lead to an improvement in the tax system. That would be heavily dependent on the form of any future capital gains tax. For example, it would seem that the Australian realised capital gains tax system has meant that tax considerations have become more rather than less important in determining business and investment decisions to the possible detriment of the overall economy. Moreover, it is possible for taxpayers to manipulate some realised capital gains tax systems so as to reduce heavily the revenue the Government might otherwise rely upon to reduce tax rates.

An alternative approach to taxing capital gains on realisation would be to tax such gains as they accrue. However, a pure accrued capital gains tax would be a very marked departure from existing income tax principles, would be difficult to administer, and could impact detrimentally and unfairly on the cash-flow of some taxpayers.

Our conclusion is that while there is a prima facie case for extending the tax base to include capital gains, the desirability of such a reform requires close analysis in the light of practical problems of implementation. In these circumstances we do not consider that specific provisions to tax superannuation funds on their realised investment gains can be justified. Instead, we consider that superannuation funds should be taxed under the same tax laws as scheme members would be taxed as direct investors. This is consistent with the proxy principle. The desirability of extending the tax base to include capital gains can then be considered, as it should be, as a general issue of taxation reform.

Our recommendation on this area would still mean that superannuation schemes would be taxed on any gain which would be assessable under specific provisions of the Income Tax Act (such as section 67) or which would be assessable under general law. We note that the ambit of the general law in particular is quite wide. Thus, even if our recommendation were adopted, superannuation funds could find that a large proportion of realised 'investment gains' are nevertheless taxable as income.

The proxy principle for taxing superannuation schemes could logically lead to schemes benefitting from any specific taxation exemptions or concessions available to individual taxpayers. The CD stated that this would not be the case and that superannuation schemes would not be deemed to be natural persons for the purpose of certain de minimus provisions in the accrual rules. Given the ability to utilise any such exemption in order to reduce an individual's taxation liability, we agree with the conclusion of the CD. The same should apply to other exemptions and concessions normally restricted to taxpayers who are natural persons - such as the exemption in section 61(13) of the Act for the first $200 of interest or dividend income.

A1.6.3 Deductible Expenditure

In general, under a T/T/E regime, a superannuation fund would be subject to normal income tax treatment on its investment income. As a result, in calculating assessable income, it would be able to deduct any expenditure or loss incurred according to normal income tax rules - such as the rule in section 104 of the Act that allows a deduction for any expenditure or loss incurred in gaining or producing the assessable income for any income year.

The CD proposed two main exceptions. These are commented on below.

First, it proposed that no deduction should be provided for benefits which a superannuation scheme pays out to scheme members. This is the counter-part to the non-taxation of contributions received and is supported.

Secondly, the CD proposed that costs incurred by the scheme which are not associated with the derivation of investment income should be non-deductible. This would include the costs incurred in developing, marketing, selling, promoting and advertising the scheme. It was suggested that administration and management expenses would be apportioned so as to attribute part to investment costs (deductible) and part to non-investment costs (non-deductible). The method of apportionment proposed was to apportion on a basis which was acceptable to the Commissioner of Inland Revenue.

The proposal to deny deductions for non-investment costs was one of the most contested specific proposals in the CD. It was strongly argued in submissions that:

- non-investment costs made up a very substantial proportion of overall superannuation scheme costs;
- such costs are necessarily incurred by the scheme in order to attract and retain contributions and a flow of contributions is a necessary prerequisite for deriving investment income; and

competing savings institutions, such as unit trusts and banks can deduct their equivalent costs.

For those reasons it was argued that those saving through superannuation schemes would be severely penalised should non-investment costs not be deductible. Superannuation schemes would therefore be unable to compete with other savings institutions.

We do not consider that all the arguments advanced in favour of the deductibility of non-investment costs had substance. For example, the argument that these costs should be deductible because they are incurred in gaining contributions which are in turn necessary in order to derive assessable investment income has little to recommend it. If that rationale were to hold for income tax in general, capital expenditure would be deductible for all taxpayers. This is not the case. Capital expenditure is generally non-deductible with, in some cases, an allowance by way of depreciation so as to spread what is in effect deductibility over the life of the capital asset.

In considering whether non-investment costs should be deductible to a superannuation scheme we have considered two questions:

a are these costs incurred to produce assessable income?

b if such costs are so incurred, are they of a revenue, rather than of a capital, nature?

If the case for deductibility is to be substantiated, the answers to both the above questions need to be in the positive.

It is arguable that these costs are not incurred in the production of assessable income. Instead they can be interpreted as the costs incurred in pooling funds so as to reduce the risk associated with any given rate of return on investment. The reduction of risk, while a benefit to scheme members, is a non-taxable benefit.

If it is accepted that non-investment costs are incurred in the production of assessable income, it is also arguable that these costs are of a capital rather than a revenue nature. They are the costs incurred in establishing the income-earning structure rather than the income itself; the costs incurred in nurturing the tree rather than the costs incurred in harvesting the fruit. A number of submissions suggested that the regularity of these costs meant that they are revenue in nature. However, the regularity in which costs are incurred has never been accepted as determinative of their revenue nature. For example, the equity-raising costs of a company or unit trust are non-deductible even if that company or unit trust is regularly seeking further equity capital.

The above comments support the CD's conclusion that non-investment costs should be non-deductible. However, this is an area fraught with complex issues. The above analysis, while useful, does not necessarily lead to the correct result. For example, if existing rules result in other financial institutions receiving some form of favourable taxation treatment with respect to deductible expenses, placing superannuation funds on a non-favoured basis would place the latter at a competitive disadvantage compared with the former.

A number of submissions drew the comparison between a superannuation scheme and a bank. The costs a bank incurs in raising funds by way of deposits are deductible. It was argued that the costs incurred by a superannuation scheme in raising funds by way of contributions should also be deductible. The counter argument to this is that a bank is taxed in its own right as a separate entity so that it can also deduct the interest costs of deposits while being taxed on interest income from the funds on-lent. A superannuation scheme, on the other hand, is not to be taxed as a separate entity in its own right. It is to be taxed as a proxy for the members with no deduction for benefits and no tax on contributions. Since, under the proxy system, assessable income is limited to investment income, deductions should be likewise limited.

However, the argument that restrictions on deductibility would place superannuation schemes at a competitive disadvantage vis-a-vis banks and other financial institutions is still, in our view, correct. The total profit a bank derives from its onlending and other investment activities is total income less total costs. This constitutes assessable income which is then apportioned between bank equity holders (as bank profit) and depositors (as interest) with tax paid by whichever party is appropriate. The point to note is that in the bank's case administration costs are fully deductible. The same should apply to superannuation schemes.

As to the argument that these costs are incurred in the process of deriving a non-assessable benefit, we agree that this is the case at least in part. To the extent that there is any problem in this area, the problem is not taxing income or benefits. Trying to deal with inappropriate income exemptions by attempting to deny deductions for expenditure, is usually futile and often has perverse results. This is the case where there has been an attempt to deny taxpayers a deduction for interest costs because there is some perceived flaw in the income tax system which allows income to be derived in a non-assessable form. The correct policy response is not to deny the deductions, but to tax the income. The denial of deductibility should only be resorted to after careful analysis of its effects. It is justified only where

the taxation of income is a particularly serious problem and taxation of the income cannot, for administrative or other reasons, be taxed.

In this case, provided that investment income is taxable, we do not consider that there is any flaw in the proposed tax treatment of superannuation schemes which is serious enough to require action. Any problems which do exist are common to most financial institutions. In the longer term, but not as a priority, the taxation of financial institutions in general should be reviewed.

The second argument advanced for restricting the ability of superannuation funds to deduct their expenses was that non-investment costs are capital costs analogous to the costs incurred by companies and unit trusts in raising equity. We agree with the analogy to some extent - member superannuation contributions may best be interpreted as hybrid debt/equity capital.

However, one of the Government's taxation reform objectives is to remove differences in the tax treatment of equity and debt. In that light it is difficult to provide a rationale for the deductibility of costs involved in raising debt capital but the non-deductibility of costs involved in raising equity capital. We conclude that equity-raising costs should be deductible on the same basis as debt-raising costs. In the meantime we do not consider this a good argument for restricting the deductibility of superannuation scheme costs.

The critical issue becomes the timing of deductibility. In economic terms, capital expenditure is merely expenditure which should be deductible over a number of income years so as to reflect the decline in the value of the capital asset. Revenue expenditure on the other hand creates no offsetting capital asset and should be deductible in the year in which the expenditure is incurred. Put another way, revenue expenditure has 100% depreciation rates whereas capital expenditure has depreciation rates of less than 100%.

There is a case for arguing that superannuation scheme costs such as the cost of any commissions, and the costs of advertising, marketing and establishing a superannuation scheme should be deductible over the period of time to which that expenditure relates rather than in the year in which it is incurred.

However, the same possible problems occur for taxpayers other than superannuation funds. We can see no reason for applying different rules for superannuation funds to the rules which apply to other taxpayers. For example, other taxpayers also incur advertising and marketing expenditure or commission expenses which give rise to long-term benefits. If existing

expenditure deductibility rules (such as the accrual expenditure rules in section 104A of the Act) are inadequate, they should be corrected on a general basis.

Our conclusion is that all superannuation scheme expenses should be deductible provided they meet the normal deductibility criteria laid down in the Act for other taxpayers.

A1.6.4 Corporate Imputation and Superannuation

The CD proposed that superannuation schemes be entitled to imputation credits on the same basis as individual shareholders. Those credits would be available to offset any tax liability the superannuation scheme has on its dividend income. Any excess credits would be available to be used to offset any tax liability on other income.

Bringing superannuation funds within the imputation system in this way was generally supported by submissions and is supported by the Committee. This aspect of the proposed taxation regime for superannuation is, in our view, critical. It will significantly reduce the tax impost superannuation schemes face as a result of these taxation changes. It will also, presumably, encourage superannuation funds to invest in shares carrying imputation credits whereas otherwise they should have been disinclined to do so.

Indeed the impact of corporate imputation highlights the fact that it has not been true to say that superannuation funds have been tax-exempt in the past, at least in respect of their income from equity investments. Instead, as shareholders they have borne tax on their share of corporate income at the corporate tax rate - in 1987/88, 48%. The combined effect of imputation and bringing superannuation funds into the tax system will mean that superannuation funds will henceforth pay tax on corporate income at the superannuation fund tax rate. This should represent a substantial reduction in the effective rate of tax borne by superannuation funds on income from this form of investment.

While critical to the operation of the taxation of superannuation fund taxation, the impact of company imputation appears, on the basis of submissions which we have received, to be poorly understood. For example, the comments in the CD on the effect of the inter-reaction with full imputation were frequently disputed on the grounds that superannuation funds were already substantial equity investors. It did not appear to occur to those who argued this point that they were stating that they had in the past been voluntary taxpayers, effectively paying tax at the corporate rate, and that the superannuation tax changes would have a corresponding reduced, and conceivably favourable, impact on their post-tax position.

A1.6.5 Recommendations

With respect to the taxation of the investment income of superannuation schemes, we make the following recommendations:

a the concept of taxing superannuation funds as a proxy for taxing income attributable to scheme members is supported;

Minister's decision: Agreed.

b superannuation schemes should not be subject to rules specific to them which would tax schemes on their realised capital gains. Instead, superannuation schemes should, in this regard, be subject to the same taxation rules as other taxpayers;

Minister's decision: Agreed.

c exemptions and concessions in the Income Tax Act which are normally restricted to natural persons should not apply to superannuation funds;

Minister's decision: Agreed.

d there should be no restriction on the ability of superannuation funds to deduct expenses, including non-investment expenses, provided the normal criteria for deductibility is met. There should be legislation explicitly allowing superannuation funds to deduct expenses incurred in gaining contributions and in marketing and administering the scheme;

Minister's decision: Reserved pending receipt of the Committee's final report which will address the taxation of life insurance.

e in the longer term there is a case for reviewing the tax treatment of financial institutions in general;

Minister's decision: Agreed.

f no specific legislation should be introduced to spread any expenditure incurred by a superannuation scheme over the period to which that expenditure gives rise to benefits to the scheme. Normal income tax rules should apply. Any changes in this area should apply to all taxpayers, not just to superannuation schemes; and

Minister's decision: Agreed.

g **the CD's proposal to allow superannuation schemes to utilise any imputation credits which they receive is supported.**

Minister's decision: Agreed.

A1.7 Tax Rates

A1.7.1 The Consultative Document Proposal

The CD proposed the following tax rates where transitional considerations did not call for concessional rates (i.e for 'new' pension and Class B lump sum superannuation schemes):

- an FBT rate for employer contributions of 35%. This rate reflected an assumed personal tax rate of 33% (the 'top' personal marginal tax rate from 1989/90) and an employer tax rate of 28% (the company tax rate from 1988/89); and

- a tax rate for superannuation schemes of 33% in 1988/89 with the rate to be reviewed for the following years in conjunction with an imputation system for superannuation schemes.

The FBT rates for employer contributions have already been legislated for in the Income Tax Amendment (No. 2) Act 1988.

A1.7.2 Setting the Scheme Tax Rate

The use of the 'top' personal marginal tax rate to set the FBT and superannuation scheme tax rates resulted in more adverse comment in submissions than any other issue of detail on the implementation of a T/T/E regime.

In general, submissions argued that, under a non-concessionary tax regime, the appropriate tax rate for superannuation schemes is a rate which approximates the average marginal rate of scheme members. It was further submitted that many, if not most, scheme members are not very high income earners and, under the new income tax scale, would be on 24% or 28% tax rates. On the whole, a 28% tax rate was seen as a reasonable approximation of the average marginal rate of scheme members (although many submissions argued for the lower 24% rate) and it was also seen as having the advantage of being equal to the company tax rate.

The argument in the CD that such tax rates would favour higher income earners was accepted. In general submissions it was strongly argued that attempting to impose the higher 33% rate would make superannuation uncompetitive as a savings vehicle. First, superannuation funds would then be at a disadvantage vis-a-vis competing investment vehicles such as companies and unit trusts which pay the 28% rate. Secondly, such a high

rate would discriminate against the bulk of existing members on lower marginal tax rates making superannuation a non-viable form of saving for such people.

Given the importance of this issue, we considered it at some length. We concluded that on the whole the submissions were based on a lack of detailed understanding of the tax rate structure.

First, the company tax rate is a less relevant consideration under imputation. Under imputation, the corporate tax rate is merely a temporary withholding tax rate. The aim is to levy the appropriate final level of tax when corporate income is distributed to shareholders. The corporate tax rate is therefore not necessarily set on the basis of the tax rates of shareholders. On the other hand, the superannuation scheme tax rate is the final tax rate. There is no top-up or refund of tax on the distribution of superannuation income. The superannuation tax rate therefore needs to be set on the basis of the tax rates of scheme members.

Superannuation funds will be taxed on their equity investments on the same basis as individual taxpayers. If the company tax rate is lower than the scheme's tax rate, the superannuation fund can shelter income in the company to the same extent as other taxpayers on the same tax rate as the superannuation scheme. If the company tax rate is higher than the scheme's tax rate, provided the company distributes its income, full imputation should ensure that, in most cases, corporate income attributable to the superannuation fund is taxed at the scheme's lower tax rate.

Secondly, the argument that a superannuation scheme tax rate equal to the 'top' personal marginal tax rate would discriminate against the majority of scheme members on 24% or 28% tax rates is not accurate.

When considering the personal tax rate structure regard has to be had to the effective tax rate structure, not just the nominal tax rate structure set out in the First Schedule of the Income Tax Act. Effective tax rates include various rebates and income support measures which the Government provides. In particular, nominal tax rates will be modified by the proposed low income rebate and family support (FSTC) abatement. This is explained more fully in Schedule 1.1.

It can be seen from Schedule 1.1 that very few superannuation scheme members are likely to be on a 24% marginal tax rate. A substantial proportion are likely to be on a 28% marginal tax rate, but overall a 33% rate is likely to be a relatively close approximation of the average marginal tax rate of members.

A 28% tax rate for superannuation schemes is more likely to be concessional than it is likely to be penal. However, if a single tax rate is required for superannuation schemes, under the proposed tax rate structure a 28% rate is in our view the preferred rate. Any higher rate would penalise the significant number of scheme members who are on an effective 28% rate.

Moreover, a number of submissions pointed out that if the company tax rate is less than the superannuation scheme tax rate, employing companies will be encouraged to run less than fully funded superannuation schemes. This is because tax on contributions will not be levied at the higher superannuation or personal rates until actual contributions are paid out. While a deduction for employer contributions should not be available until contributions are made, there would nevertheless be a small tax advantage in deferring the timing of contributions.

We recognise this as a significant problem. It is one of a number of problems created by setting the corporate tax rate below personal tax rates. However in the superannuation context it is even more important than elsewhere. Setting the superannuation tax rate higher than the company tax rate would provide an incentive for employers to self fund schemes.

A1.7.3 Transitional Rates

The CD proposed that as a transitional measure, the tax rate for "existing" pension schemes and class A lump sum schemes should be set at a concessional rate of 25%.

We understand that for the purpose of actuarial calculations, most schemes are currently assuming that the future non-concessionary rate of 33% will apply. There is thus little advantage to not providing a stated date at which all schemes will move onto a non-concessionary rate. To assist schemes over the period in which they are re-negotiating benefits, there is a case for continuing the concessional rates until 1 April 1990. However if the non-concessional scheme tax rate is set at 28%, we are of the view that a 3% differential in tax rates would add complexity to tax law with little offsetting advantage. We therefore recommend that the 28% rate apply to "existing" pension schemes and class A funds from the beginning of the 1989/1990 income year (the 25% rate to apply up to the beginning of that year).

We further recommend that class B funds continue to be subject to the existing taxation basis (which involves a 33% rate) to the beginning of the 1989/90 income year, at which point they should also move on to a 28% rate. As a result of these measures, from the beginning of 1989/90 all schemes will be taxed on the same basis, and at 28%.

A1.7.4 Setting the Employer Contribution Tax Rate

If the tax were to be levied on employer contributions at a rate reflecting the average marginal rate of scheme members, it would seem that the appropriate rate would be close to 33%. However, in our view many employers would resist making contributions if their withholding tax rate exceeded the rate at which those contributions are deductible (i.e. the employer tax rate of 28%). It is particularly important that employers do not face a perceived or real tax disincentive to operating superannuation schemes. We therefore recommend that so long as the employer tax rate is lower than average personal rates, the tax rate on employer contributions be aligned with employer rates. We recommend the tax rate on employer contributions should be set at 28%.

A 28% tax rate for employer contributions would correspond to a 28% non-deductible FBT rate, applicable from the first quarter of the 1989/90 income year.

A1.7.5 Other Considerations

Further consideration is given to the inter-reaction between FSTC and the superannuation measures in section A1.9. Section A1.10 considers the possibility of introducing a method by which the income of the superannuation scheme could be imputed to scheme members and taxed in their hands.

A1.7.6 Recommendations

With respect to tax rates we make the following recommendations:

a **a single tax rate, to be applied to superannuation funds in the context of the proposed income year, of 28%;**

b **the 28% rate apply to existing pension schemes and class A funds from the beginning of 1989/90 income year (the 25% rate to apply up to the beginning of that year);**

c **that class B funds continue to be subject to the existing taxation basis (which involves a 33% rate) to the beginning of the 1989/90 income year, at which point they should also move onto a 28% rate;**

d **the rate on employer contributions from 1 April 1989, and the corresponding FBT rate, should both be 28% under the current tax structure.**

Minister's decisions:

a the concessional tax rate of 25% rate will apply to the earnings of Category 1 schemes existing as at 17 December 1987 until 31 March 1990 (schemes with other balance dates will apply this rate to the proportion of their income corresponding to the proportion of their income year falling before this date);

b schemes that are currently taxed at 33% will continue at this rate until 31 March 1990. New approved schemes will also be taxed at 33% from 1 April 1988 to 31 March 1990;

c the issue of the appropriate non-concessional tax rate to apply to the earnings of superannuation schemes from 1 April 1990 will be addressed during the transition period in the light of the Committee's concerns;

d the rate of withholding tax on employer contributions to registered superannuation schemes will be set at 33% from 1 April 1989.

A1.8 The Taxation of Benefits

A1.8.1 The Present Position and the Consultative Document's Proposals

Current law on the taxation of superannuation benefits, as it has been applied, is relatively simple. Essentially a distinction has been drawn between capital or lump sum benefits which are not assessable in the hands of the beneficiary and income or pension benefits which are so assessable. As a result, any benefits under a lump sum scheme are at present, in general, not subject to tax. The same applies to benefits under a pension scheme which are received in a lump sum form. Taxation is only levied on pension benefits from such a scheme.

There are a number of circumstances in which pension schemes have been able to provide members with non-taxable lump sum benefits. These can include various forms of disability and death benefits, early withdrawal and benefits on the winding-up of the scheme, and the 25% commutation and any specified lump sum benefit on retirement.

In line with a T/T/E regime, the CD proposed that the taxation exemption currently afforded lump sum benefits also be extended to cover pension benefits. Apart from the issue of national superannuitant surcharge, it would then become irrelevant, as far as the tax system is concerned, as to the form in which the superannuation benefit takes.

A1.8.2 Comment

Exempting all superannuation benefits, lump sum and pension, from taxation is consistent with a T/T/E taxation regime. As a general principle there is logic and considerable merit in taxing in a consistent manner all benefits from schemes which have previously been subject to the same taxation regime.

A1.8.3 Definition of Exempt Benefit

In order to apply a taxation exemption to superannuation scheme benefits, such benefits will need to be defined. We can see no valid taxation reason why the definition of a superannuation scheme benefit should not be very broadly defined under a T/T/E regime to be any retirement or similar benefit derived by any person whatsoever and provided by a registered superannuation scheme. A benefit will include any benefit (such as a low interest loan) provided by a superannuation scheme which would be a fringe benefit if it were provided by an employer of the recipient under Part XB of the Income Tax Act.

We can see no reason why the exemption should not also apply to benefits derived by non-residents.

It is possible that an employer could arrange for employees to receive what would otherwise be fringe benefits (for example, a low interest rate loan) through and by arrangement with a superannuation scheme. Section 336N(2) of the Act as presently drafted is likely to deem such a benefit to be a benefit provided to the employee by the employer and thus, if appropriate, the employer would be liable for fringe benefit tax on the value of the benefit. However, it was previously proposed that any benefit which an employer provides to a superannuation scheme would be either taxable as income of the scheme or would give rise to a FBT liability. There would thus be no reason to impose FBT on benefits provided to employees, by arrangement with the employer or otherwise, by superannuation schemes. Section 336N(2) will need to be amended accordingly.

A1.8.4 Subjecting Benefits to National Superannuitant Surcharge

A difficulty with any taxation regime for superannuation is how it should mesh with the national superannuitant surcharge which aims to target assistance to those elderly who are in greater need. Since the surcharge is largely based on assessable income, present rules subject pension benefits to the surcharge but not lump sum benefits.

By making pensions but not lump sum benefits surchargeable, people were encouraged to take their benefits in lump sum form. This has been mitigated to some degree by the greater

tax concessions provided to pension schemes which have limitations on the extent to which they can provide benefits in non-pension form. The removal of pension superannuation scheme tax concessions would leave pensions an unattractive form of benefit. Moreover, continuing to surcharge benefits in full would appear inconsistent with a T/T/E regime. Since a pension consists of both a return of capital and an income element, surcharging the pension would result in the taxation of capital withdrawals. It would be equivalent to levying the surcharge on bank deposits withdrawn by national superannuitants.

The theoretically correct approach would be to leave all superannuation benefits, including pension benefits, free of surcharge, but to levy the surcharge on that part of the income of the superannuation fund which is attributable to those on national superannuation who would be subject to the surcharge if that income were derived directly by them. This 'pure' approach, however, would be complex and difficult to achieve.

The CD suggested that the distinction between surchargeable pension benefits and non-surchargeable lump sum benefits be retained but that the surcharge on pension benefits be restricted to half the pension. In other words, under this proposal, only half the value of the pension would be added to a national superannuitant's "other income" subject to the surcharge. We were informed that the proportion of half the benefit was arrived at as an approximation of the proportion of the pension which, over the life of a 60 year old beneficiary, would be likely to be attributable to superannuation scheme investment income derived from commencement of pension payments assuming average investment returns and life expectancies.

This proposal would be very much a compromise. It would result in too little of the pension being subject to surcharge in the early years (when the pension is mainly interest on the sum invested to support the pension), and too much in a national superannuitant's later years (when the pension is mainly the return of capital). Similarly, those with higher than average life expectancies (eg women) would be under-surcharged while those with lower than average life expectancies (eg men) would be over-surcharged. On the other hand, the option of calculating interest and capital components of the pension on an actuarial basis clearly involves compliance and administrative costs which are too high.

If it is considered necessary to retain the surcharge on superannuation benefits, we consider that limiting the surcharge to half of any pension benefit is the best available option.

However, we consider that there are good reasons for not applying the surcharge to superannuation benefits at all. While the proposal in the CD can be theoretically justified, it has the following practical disadvantages:

a it would add complexity to an aspect of the taxation system which is already too complex for the majority of taxpayers it affects to understand and easily comply with;

b its rationale (that a proportion of benefits should be surcharged as a proxy for investment income derived by a superannuation fund and attributable to the national superannuitant beneficiary) applies equally to lump sum benefits. The difficulty of applying this approach would be that the proportion of the lump sum benefit which should be surcharged varies according to the amount of income which has been sheltered from the surcharge by being derived by the superannuation fund. While this amount can be very roughly approximated for a life annuity by assuming an average life expectancy, no such reasonable approximation is possible for other forms of benefit. The CD proposed to deal with this problem by categorising any superannuation benefit received in more than one instalment as a pension benefit subject to the surcharge. While this was aimed at techniques currently used to avoid the surcharge, the real problem is not the frequency of lump sum payments. Instead it is the ability to shelter income in a superannuation fund. This applies even if the benefit is in one lump sum payment. For example, the surcharge could be avoided by having a lump sum superannuation scheme and by financing consumption expenditure by borrowing money from the scheme. Moreover, the CD proposal would require complex anti-avoidance rules (where different superannuation schemes are used to provide different lump sum benefits) which would be difficult to draft in a workable manner and even more difficult to police. Finally, submissions pointed out that the proposal would create anomalies since lump sum schemes sometimes provide an interim benefit on retirement followed by a final benefit when the beneficiaries entitlement is more precisely calculated; and

c superannuation is only one of a number of ways in which it is possible to shelter income from the surcharge. Other methods include investment in capital assets producing non-assessable benefits, and the use of life insurance policies, unit trusts, and ordinary trusts. As a result, it is not too much of an exaggeration to say that national superannuitant surcharge is, as presently structured, largely a

voluntary tax for all but those who receive employment income or superannuation scheme pensions.

Our conclusion is that retaining the national superannuitant surcharge on pension superannuation benefits would, under a T/T/E regime, unfairly discriminate against this form of retirement provision and encourage people to take retirement benefits in other forms. It would thus discriminate against a benefit form which is particularly efficient at providing security in retirement and at covering people against the inevitable uncertainty over length of retirement. Extending the surcharge to cover lump sum benefits would penalise that form of benefit and encourage people to provide for their retirement otherwise than by way of superannuation.

Our preferred approach, therefore, would be to remove the surcharge from all superannuation benefits. The future role of the surcharge should be reviewed in the context of an overall review of the public provision of retirement income support. If, as a result, the targeting of national superannuation to those in greater need is determined to be desirable, the surcharge or its replacement should be restructured so that it better meets this objective. One response would be to target national superannuation on the basis of assets and income from employment. An assets test could be structured so as to treat superannuation in a consistent manner with other forms of retirement. As it is presently structured, the surcharge cannot do this.

We note that not applying the surcharge to superannuation scheme benefits would remove any disincentive to private provision of retirement income which the surcharge presently imposes by moving national superannuitants on to high effective marginal tax rates. On the other hand, not imposing the surcharge would result in a fiscal cost which will need to be recouped by way of higher taxes on other taxpayers. On the basis of household and expenditure survey data analysed by the Treasury, it is estimated that the annual fiscal cost of foregoing the surcharge on presently surcharged superannuation benefits would be about $15 million.

A1.8.5 Recommendations

With respect to superannuation benefits, we make the following recommendations:

a **allowing all benefits, pension and lump sum and whether or not derived by residents or non-residents, to be paid out of a superannuation scheme tax-free is supported as consistent with a T/T/E regime;**

Minister's decision: Agreed

b **a superannuation scheme benefit should be widely defined as any retirement or similar benefit derived or otherwise received by any person whatsoever and provided by a registered superannuation scheme;**

Minister's decision: Agreed

c **superannuation scheme benefits should not be subject to the national superannuitant surcharge even if received in the form of the pension. The national superannuitant surcharge should be reviewed in the context of an overall review of state retirement income support with consideration being given to targeting any such support on the basis of assets rather than income.**

Minister's decision: Reserved, pending further consideration of the whole issue of provision of retirement income support.

A1.9 Relationship Between a T/T/E Regime and State Targeted Income Support Measures

A1.9.1 The Problem

One issue not considered in detail by the CD was how the proposed superannuation tax regime would inter-react with a number of income support measures which are targeted on the basis of household or individual income. National superannuation is one such targeted income support measure. As discussed above, we recommend that the surcharge not apply to superannuation benefits but that consideration be given to using assets or wealth to appropriately target this form of assistance.

There are a number of other targeted income support measures such as Family Support, the Guaranteed Minimum Family Income (GMFI), and the low income rebate (all of which operate through the income tax system). In addition, there are a number of other measures operating outside the income tax system such as housing assistance and assistance to dependents undertaking education or training. All these measures aim to target assistance to low income earners and abate out over an income range.

As with national superannuation, the difficulty is that the abatement of benefits can result in very high effective marginal tax rates for those recipients in the abatement range. Thus, recipients of GMFI have 100% effective marginal tax rates, while Schedule 1.1 demonstrates the high effective marginal tax rates possible under the low income rebate and Family Support. To prevent such people from getting a tax advantage from the use of superannuation schemes, the tax rate

applying to employer superannuation contributions and superannuation scheme investment income would have to be at least equal to the effective marginal tax rates of GMFI and Family Support recipients. However, tax rates set at this level would penalise other superannuation scheme members making superannuation a non-viable form of saving.

The essential problem, therefore, is that the effective marginal tax rates of many taxpayers who are recipients of various forms of targeted assistance are higher than any tax rate which can reasonably be imposed on superannuation funds and employer contributions. It is to be noted that this is not a problem peculiar to superannuation benefits. It also applies to employee fringe benefits such as low interest loans.

A1.9.2 Comment

We have come to the view that a relatively low tax rate on superannuation scheme investment income is not likely to cause major problems with respect to the administration of income-targeted benefits. It is likely that only a relatively small proportion of superannuation scheme investment income will be attributable to the targeted income groups.

Employer superannuation contributions, on the other hand, could be more significant for this group. One option would be to require employers to attribute their superannuation contributions to particular employees. Employees would then include those contributions in their taxable income with a credit for the tax paid on behalf of the fund.

To make this workable, some form of approximation would be required. The only apparent way of doing this would be to apportion contributions on the basis of the source deduction payments made to employees in the course of the year. However, in many cases with defined benefit plans, that would tend to over-state the contributions attributable to the more junior and lower paid staff while under-stating contributions attributable to more senior and higher paid staff. We consider unacceptable a tax system which would under-tax the highly paid while over-taxing the lower paid.

This illustrates why the CD, and submissions we received on the point, concluded that employer contributions could not practically be taxable in the hands of employees.

It has to be accepted that any viable tax regime will involve some anomalies. No New Zealand taxpayer is subject to tax on all income in its purest theoretical form. Indeed, it is probably true that no form of income is subject to tax in this way. The appropriate policy response is to bring income as close as practically possible into normal income tax treatment thereby limiting anomalies. Where practical constraints continue to pose problems, specific legislative rules should be targeted at preventing remaining anomalies from being

utilised in a manner which flagrantly abuses the intent of the legislation.

In this case, a T/T/E regime would bring superannuation as close as practically possible into normal income tax treatment. Practical constraints mean that this would still leave some taxation advantages for a group of taxpayers. However, there is an area of potential abuse for which counter-vailing rules seem desirable. This is the possibility of paying a high proportion of the salary or wages for those on Family Support in the form of employer superannuation contributions. Employee income could then be simply 'washed' through the superannuation fund thereby incurring the relatively low tax rate.

To prevent such abuses, we recommend that any benefit provided by a superannuation fund to any person where:

a an employer of that person has made contributions to that superannuation fund within the income year or preceding income year in which the benefit was provided; and

b that person remains an employee of the employer at the time the benefit was provided; and

c that person has within the current, or two income years preceding the current, income year, received any other benefit from a superannuation fund to which the employer made contributions,

be taxable in the hands of the person but with a tax credit, utilisable against only that income, of 28 cents in the dollar.

We anticipate that such an anti-abuse rule is so narrow that it would never be invoked. But it should be sufficient to prevent flagrant abuses of the intention of the legislation.

A1.9.3 Recommendation

Given that some taxpayers will be on effective marginal tax rates significantly higher than the recommended tax rate on employer contributions, it is recommended that an anti-abuse measure be enacted along the lines outlined above.

Minister's decision: Agreed in principle. The anti-avoidance measure will provide that withdrawals from superannuation schemes (less the member's own contributions) will be taken into account for the purpose of calculating family support and GMFI in the current year where withdrawals are received by an employee:

- in the current or subsequent income year; and

- while still employed by an employer who has made contributions in the current or preceding income year.

Thus family support payments received in one year because employer contributions reduced income to a level that qualified, will be clawed back if those contributions are withdrawn in the same or subsequent year.

A1.10 Miscellaneous Considerations

A1.10.1 Issues Considered

This section considers three issues raised by the CD and/or by submissions. These are: the application to superannuation funds of the proposed new provisional tax rules, the taxation of 'clawbacks', and a possible imputation system for superannuation funds.

A1.10.2 Provisional Tax Rules

A number of submissions argued that superannuation funds should be exempt from the proposed new provisional tax rules on the grounds that the income of such funds was likely to be uncertain. Changes to the provisional tax system are outside our terms of reference. Superannuation funds have the same income characteristics as many other taxpayers. We see no justification for exempting schemes from the requirements imposed on other taxpayers.

It is noted, however, that employer superannuation contributions will be subject to final withholding tax payable by the employer. Such contributions should therefore constitute a source deduction payment so that income from that source should not constitute provisional income of the superannuation fund.

A1.10.3 Clawbacks

Clawbacks may occur when, because of a better than expected investment performance by the superannuation scheme, the scheme is over-funded - i.e. has more investment assets than the promised level of benefits require. In such cases it is possible for contributing employers, if the trust deed allows, to receive back from the fund its excess contributions.

Currently the taxation position of clawbacks is uncertain. Clawbacks are a form of superannuation benefit which flows to the employer rather than the employee. A T/T/E regime ensures that there is no taxation advantage from superannuation scheme savings. Thus there is no reason to treat clawbacks differently from any other form of superannuation scheme benefit. Clawbacks should be payable to a contributing employer tax-free.

We do, however, recommend one exception. It is possible that some employers could attempt to use end-of-year superannuation contributions which are clawed back in the beginning of the next income year so as to defer the timing of tax payments under the provisional tax rules. This seems unlikely as long as the tax rate on employer contributions is higher than the company tax rate. Nevertheless, the tax rules should not be dependent upon a particular tax rate structure which is likely to change over time. To minimise the possibility of abuse, we recommend that where an employer receives any benefit from a superannuation fund, a deduction for any contributions it has made to that fund within the preceding six months should be denied.

We received a number of submissions arguing that since employer contributions could be taxed at a rate higher than the employer's tax rate, the employer should, as well as receiving clawbacks tax-free, also receive refunds of the excess tax paid. The employer is in the same position as any other superannuation scheme beneficiary. There is no more reason to provide refunds for excess tax paid in its case than in the case of scheme members. Moreover, under imputation the ultimate effective tax rate on companies is the tax rate of the equity holders. Under the present rate structure it is likely that those equity holders are on tax rates as high as the superannuation tax rate. This further reduces the justification for tax refunds on clawbacks.

A1.10.4 An Imputation Scheme for Superannuation Funds

The CD suggested that the Committee would consider methods by which the income of superannuation funds could be imputed to scheme members. A number of suggestions in this regard were raised in submissions. Any imputation scheme would need to bring into the income of scheme members income which is vested in those members. To prevent abuse both employer and employee contributions would need to be taxed in the hands of the fund.

As already discussed, under the existing rate structure most scheme members would be likely to be on tax rates equal to or in excess of the superannuation scheme tax rate. An imputation regime is only truly effective where there is a lower effective tax rate and thus an incentive to impute income. We have come to the view that the rate structure does not justify the extra complexity which an imputation regime for superannuation funds would require.

A1.10.5 Recommendations

It is recommended that:

a normal provisional tax rules apply to superannuation schemes but that employer contributions be source deduction payments and not be included in provisional income;

Minister's decision: Agreed.

b clawbacks of employer contributions be tax-free but that where an employer receives any benefit from a superannuation fund, a deduction for any contributions it has made to that fund within the preceding six months should be denied; and

Minister's decision: Agreed, except that the period for the denial of deductions will be 12 months prior to a withdrawal.

c an imputation regime for superannuation funds is not justified by the extra complexity such a regime would require.

Minister's decision: Agreed.

A1.11 Non-Registered and Non-Resident Schemes

A1.11.1 The Consultative Document

The CD proposed that employer contributions to non-registered/ non-resident schemes be non-deductible and subject to FBT at normal rates (currently 48%). This corresponds to the existing tax treatment of non-approved schemes, and is penal in that employer contributions are effectively subject to double taxation.

A1.11.2 Comment

The major concern in this area is that non-resident employers could make superannuation contributions for the benefit of NZ resident employees, in circumstances where the superannuation scheme is not subject to NZ tax, because the scheme is not a NZ resident scheme, and (not having a NZ resident settlor) would not be taxable under the proposed international tax regime.

Non-resident superannuation schemes should, as appropriate, be subject to normal international tax rules. However, there is no practical way that non-resident superannuation schemes without a resident settlor can be made subject to NZ income tax. To reduce the scope for abusing this constraint on the operation of NZ tax laws, we support the CD's proposal.

We note that under the proposed changes to New Zealand international tax law, a NZ resident trust will be defined as a trust with a NZ resident settlor. NZ resident superannuation funds should be similarly defined.

Most superannuation funds which have NZ resident employees should, if they so wish, be in a position to establish NZ residency. We therefore see no need to provide provisions for deeming certain non-resident trusts to be resident in New Zealand, as proposed by the CD. There are likely to be cases where the tax treatment recommended above unfairly penalises employers. This would occur where an overseas company employs NZ based staff who belong to an offshore superannuation fund. Nevertheless, if the scheme itself is not subject to NZ tax, we agree that some penal provision affecting employer contributions is justified.

A1.11.3 NZ Resident Non-registered Schemes

We do not see the same rationale applying to non-registered schemes which will be subject to tax on investment income as NZ residents. There is in our view no justification for penal tax treatment in such cases. We recommend that such schemes should be taxed at normal trustee tax rates.

A1.11.4 Benefits

All benefits from non-resident and non-registered schemes should be taxed or exempt, as the case may be, as is provided for under general tax law.

A1.11.5 Recommendations

It is recommended that:

a **the CD's proposal to deny deductions for employer contributions to non-resident superannuation schemes, and to subject such contributions to FBT, be implemented;**

b **non-resident superannuation schemes be subject to normal international tax rules;**

c **a resident superannuation scheme be defined as a superannuation scheme with a NZ resident settlor;**

d **employer contributions to resident non-registered superannuation schemes be deductible to the employer but subject to FBT at normal rates and that the income of such trusts be taxed at normal trustee tax rates.**

Minister's decision: Agreed in principle. However, for consistency with the trust regime approved by the Government in response to the recommendations of the Consultative Committee on Full Imputation and International Tax Reform, the Committee's recommendations have been modified as follows:

a employer contributions to non-registered superannuation schemes which do not have a resident trustee will be non-deductible and subject to FBT at normal rates;

b non-registered superannuation schemes will be taxed in the same way as other trusts;

c to be registered, a superannuation scheme must have a resident trustee;

d employer contributions to non-registered superannuation schemes with a resident trustee will be deductible to the employer but subject to FBT at normal rates and the income of such trusts will be taxed at normal trustee tax rates; and

e trustees of registered superannuation schemes will not be liable for tax under the tax regime applying to other trusts.

SCHEDULE 1.1
TAX RATE SCALE

1 This schedule outlines the new tax rate scale as previously announced by the Government as incorporated in the Taxation Reform (No 4) Bill 1988. It demonstrates that it is not correct to assume that most superannuation scheme members or beneficiaries will be on 24% or even 28% marginal tax rates even if their incomes are relatively low. Instead, it seems likely that most scheme members will be on the top personal marginal tax rate (40.5% in 1988/89 and 33% in 1989/90) and a proportion will in fact be on significantly higher marginal tax rates than these top rates. This is because of the abatement of various income support measures in place. Contrary to many of the submissions which we received, therefore, we consider that a 33% rate for superannuation schemes is not, in most cases likely to be penal for scheme members.

2 The new individual rates will be:

	1988/89
under $9500	19.5%
$9500 - $30000	27%
$30000 - 30875	36%
over $30875	40.5%

	1989/90
under $30875	24%
over $30875	33%

3 The important point is the difference between these nominal rates and effective marginal tax rates. Effective marginal tax rates include such items as national superannuitant surcharge and the abatement rate for various income support measures. The most obvious measures to include when considering effective marginal tax rates are the new low income rebate, guaranteed minimum family income (GMFI), and family support (FSTC).

4 The first income support measure to consider is the new low income rebate introduced in the Bill as a proposed clause 50C. The rebate applies to all taxpayers who are natural persons - unlike the "transitional" tax allowance, it is not restricted to full-time earners and non-spouses of FSTC recipients. The rebate is 9% of assessable income (excluding income in the form of interest, royalties, dividends and rents) up to $9500 of income. It abates (ie is reduced) by 4% of assessable income (including income in the form of interest, royalties, dividends and rents) which exceeds $9500. It thus completely abates out at an income level of $30875. The full rebate does not come into effect until the 1990 income year. In the 1989 income year the rebate is 4.5% abating out at 2%.

5 The effective tax rates, including the low income rebate, are therefore:

	1988/89
under $9500	15%
$9500 - $30000	29%
$30000 - 30875	38%
over $30875	40.5%

	1989/90
under $9500	15%
$9500-$30875	28%
over $30875	33%

6 It has been proposed to increase the GMFI income level, with effect from 1 April 1988, to $300 per week. For those who qualify, the effective marginal tax rate is 100%.

7 The most important form of income support altering effective marginal tax rates, apart from the low income rebate, is probably family support (FSTC). FSTC provides a payment of $1872 for families with a dependent child and $832 for each additional child. It is abated, based on household income, at the rate of 18% in 1987/88. Abatement begins at $15,000.

8 The proposed new abatement rates for 1988/89 are:

up to $15000	0
$15000 - $16000	9%
$16000 - $27000	18%
$27000+	24%

FSTC will thus abate out at the following levels of 1988/89 household income:

one child	$25,900
two children	$29,642
three children	$33,109
four children	$36,576
five children	$40,043

9 The proposed abatement rates for 1989/90 are:

up to $16000	0
$16000 - $27000	18%
$27000+	30%

FSTC will thus abate out at the following levels of 1989/90 household income:

one child	$26,400
two children	$29,413
three children	$32,187
four children	$34,960
five children	$37,733

10 If FSTC abatement is taken into account, the effective marginal tax rates for a three-child single-income family are:

1988/89

under $9500	15%
$9500 - $15000	29%
$15000 - $16000	38%
$16000 - $27000	47%
$27000 - $30000	53%
$30000 - $30875	62%
$30875 - $33109	64.5%
$33109+	40.5%

1989/90

under $9500	15%
$9500 - $16000	28%
$16000 - $27000	46%
$27000 - $30875	58%
$30875 - $32187	63%
$32187+	33%

11 It can be seen that the highest marginal tax rate is well above 33% in 1989/90.

12 At our request, the Treasury produced analyses of the likely spread of effective marginal tax rates using data from the Household Income and Expenditure Survey on the basis of the proposed 1989/90 tax scale including the low income rebate and FSTC. For those working more than 30 hours per week with an annual taxable income exceeding $15,000, it is estimated that 58% would have a marginal tax rate of 28%, 30% would have a marginal tax rate of 33%, and 12% would have higher marginal tax rates ranging between 46% and 63%.

13 Many of these individuals would be secondary income earners and the very young who would not be likely to belong to a superannuation scheme under any superannuation taxation regime. The analysis was redone including only those who make superannuation contributions. This showed 44% on a 28%

marginal tax rate, 47% on a 33% marginal tax rate, and 9% on higher tax rates. Of those on the 28% marginal tax rate, 45% derived a level of income just below the level at which the tax rate would rise to 33%.

14 If employer superannuation contributions and income derived by the scheme were attributed to individual scheme members, it is likely that many of those on incomes just below the 33% tax rate would be pushed up into this higher tax bracket. Moreover, it is reasonable to assume that the level of employer and employee superannuation contributions are higher for upper income earners and that upper income earners would have attributable to them a disproportionate share of scheme income.

15 We conclude that if a single tax rate is to be applied to superannuation schemes so as to reflect the marginal tax rate of scheme members, the appropriate rate under the 1989/90 tax scale would be close to 33%.

16 National superannuitant surcharge can also cause effective marginal tax rates to vary from nominal rates. This is likely to be mainly the case for beneficiaries of superannuation schemes.

17 It is proposed to reduce the "other income" threshold from $7800 to $7202 for a single national superannuitant, and from $6500 to $6006 for a married national superannuitant from 1 April 1989. The surcharge rate is proposed to increase as follows:

1987/88	18%
1988/89	19%
1989/90	20%

18 With national superannuation currently being, in gross terms, $9544 for a single person and $7953 for a married person, the surcharge increases effective marginal tax rates at $16746 for a single person and $13959 for a married person where the spouse has other income of at least $6006, and at $19965 where the spouse has no other income. In most cases the surcharge will abate out at the $45000 to $50000 income range. Excluding FSTC, this can produce marginal tax rates of 57% to 59.5% in 1988/89 and 48% to 53% in 1989/90. With FSTC, effective marginal tax rates can climb to over 80%.

19 On the basis of data analysed by the Treasury, approximately 50% of those receiving private superannuation benefits will be on a 28% marginal tax rate, and 30% will be

on 48% marginal tax rates. Of those on the 28% rate, about two thirds would receive relatively small pension benefits (less than $6000). Again, the 33% rate seems a relatively close approximation to the overall marginal rate for this group.

20 Finally, it should be noted that effective marginal tax rates for lower income earners can be higher than the rates used above. This is because there are various other income support and assistance measures which are effectively targeted on the basis of household or individual incomes. Examples are assistance for young people undergoing education or training, and housing support delivered in various forms. Again, this reinforces the view we have come to that superannuation scheme tax rates lower than 33% are on average more likely to be concessionary than they are likely to be penal.

APPENDIX 2 - TAXATION UNDER MODIFIED EXEMPT/TAXED/TAXED

A2.1 Introduction

A2.1.1 Purpose of Appendix on Taxation under Modified Exempt/Taxed/Taxed (E/T/T)

This Appendix sets out the recommended tax treatment of Retirement Income Fund contributions, fund earnings and benefits under a modified exempt/taxed/taxed regime.

A2.1.2 Outline and Summary of Appendix

We believe that it is necessary to distinguish clearly between the features needed for registered Retirement Funds, and the features currently existing and commonly understood for "superannuation" schemes. There are significant differences. We therefore use the term "Retirement Income Fund" ("RIF") in the context of registered pensions schemes to which the modified E/T/T will apply, (and in the context of lump sum schemes and other non RIF schemes we use the term "Retirement Lump Sum Fund" ("RLSF")). Appendix 5 contains an Explanatory Memorandum and draft legislation.

In relation to **taxation matters**, we propose the following features:

- for a RIF the total special exemption for contributions payable by or on behalf of an individual are limited to 20% of the individual's taxable income;
- for a RLSF there will be no tax deduction for contributions;
- for both RIFs and RLSFs, income of the fund will be taxable at 28%;
- for a RIF, pensions will be fully taxable as income when paid to the member;
- for a RIF 25% of the total pension can be taken as a cash lump sum;
- for a RIF where a cash lump sum is taken on retirement on or after eligibility for National Superannuation, it is taxfree up to a limit of $75,000, with any excess being treated as assessable income in the year of receipt. Cash lump sums taken before eligibility for National Superannuation are taxable in the year of receipt;
- existing tax free lump sum withdrawal entitlements and existing termination entitlements for approved employee pension schemes, established as at 30 June 1988, will be maintained even if they exceed the 25% pension/$75,000 limit referred to above;

for a RLSF, the benefit will not be taxed whether taken as a lump sum or as a pension;

A2.2 Definition of Superannuation

The comments and recommendations on the definition of superannuation made in Appendix 1 for T/T/E apply equally for modified E/T/T.

A2.3 Member Contributions and Employer Contributions

A2.3.1 Previous Position

The descriptions are set out in Appendix 1, Clause A1.3.1 and Clause A1.4.1. The position taken under the CD with regard to T/T/E is set out in Appendix 1, Clause A1.3.2 and Clause A1.4.2.

The requirements for both member and employer contributions to a registered RIF under the modified E/T/T regime have different income tax consequences from the T/T/E regime because contributions under modified E/T/T are deductible (whereas under T/T/E there is no tax deduction).

A2.3.2 Special Exemption for Contributions

In relation to modified E/T/T, we propose a limit on the level of tax deductible contribution. The limit we suggest is 20% of the individual's taxable income including any employer contributions, which limit would apply to all contributions paid by or on behalf of the individual; any excess of employer contributions beyond that amount would be deductible but subject to FBT. Any excess of employee contributions would not be deductible.

The Committee was originally attracted to the idea that there would be no such limit. However the opportunities for tax planning, with existing schemes being wound up and the proceeds being put into a new registered RIF, thereby achieving deductibility twice for the same monies, indicated that a contributions limit is necessary.

A2.3.3 Explanation of the Limit

The proposed 20% limit needs some explanation. First, we are concerned that RIFs have the <u>potential</u> to be used as income sheltering mechanisms if there is no limit. Second, we are concerned to ensure that the Government's tax base is adequately protected. It may well be the case that 20% is too low, but experience will demonstrate that. Third, our actuarial advice is that the standard in the industry is the Government Superannuation Fund; in order to provide a satisfactory pension level, a total contribution of between 16% and 20% of salary is required in terms of the existing E/E/T

regime. It will need to be higher under E/T/T, even allowing for a 30 - 40 year contribution period because of the middle "T". Accordingly, our proposed 20% level is the minimum, and that it may need to be raised quite shortly. Lower tax rates will effect this.

A2.3.4 The Mix between Employer and Employee Contributions

Where a member joins a Fund and the member is independent of an employment relationship, the 20% limit proposed causes no difficulty. Such a person would simply deduct up to 20% of his or her taxable income.

There is greater difficulty caused by employers offering subsidised schemes. For example, if an employer makes membership compulsory, being a condition of employment, the value of the employees' 20% deduction depends entirely on the terms of the Fund. If the employee is attributed with an employer contribution of exactly 20%, the employee is unable personally to contribute on a deductible basis. If that person then leaves, the terms of the Fund would ordinarily provide for very modest vesting, if any.

The point is that the employer contribution is usually "offered" on the basis that it forms part of employee's remuneration base. Strictly speaking, this is often illusory, because of very low vesting terms, until many years of service have been completed. At first sight, the simple solution is to leave the issue of "vesting" of employer contributions to contract between individual employees and employers. The question is whether this is appropriate, if employees in reality do not have equality of either knowledge or bargaining power, with regard to conditions of employment. This arises in relation to the "value" that can be attributed to "unvested" employer contributions, nominally made on behalf of the employee.

Compulsory membership is the key issue. If an employer is permitted to make membership compulsory, the 20% limit we propose is effectively assumed by the employer in relation to that employee. And yet, under the present types of scheme, that employee may get very little benefit. A number of possibilities occur, including:

- making compulsory membership of employer subsidised schemes unlawful;

- permitting compulsory membership of employer subsidised schemes on condition that such schemes offer defined, certain, levels of vesting. Indeed, there is a case for "compulsion" meaning that there must be immediate 100% vesting.

Our view is that compulsory membership is, in effect, something of a tie-in agreement. For that reason, we favour immediate 100% vesting for such Funds.

If membership of an employer subsidised Fund is voluntary, the level of vesting in relation to the employer contribution should be a matter of contract.

For the purposes of determining the amount the employee may claim as a deduction, the limit will be 20% of total income less any RIF contributions made by his or her employers, as shown on the PAYE certificates. In effect, the employer's contributions have "first claim" on the 20% limit, with the balance being available to the employee.

In a defined contributions scheme, there is no difficulty in ascertaining the employer contribution in respect of each employee. In a defined benefit scheme, there is not the same nexus. Accordingly, for tax purposes the employer will have to attribute contributions amongst employees in proportion to salaries.

PAYE certificates will need to be amended from 1 April 1989, so that employers provide the Inland Revenue Department with the necessary information to police the overall 20% limit, between employer and employee.

A2.3.5 Further Limit on Special Exemption for Contributions

Where a member has received any tax free benefit established as at 30 June 1988 from a RIF (which excludes a transfer of benefits to another RIF) neither the member nor any employer of that member would be permitted to make any deduction for contributions in respect of that member to a RIF for three years from the end of the tax year in which the member received the tax free benefit. PAYE certificates will require amendment to provide the Inland Revenue and "new" employers with the necessary information.

A2.3.6 Matters from Appendix 1 Discussion of Member and Employer Contributions that apply to Modified E/T/T

The discussions of Section 75 of the Income Tax Act 1976 and Section 96 of the Income Tax Act 1976 contained in Clause 1.4.8 of Appendix 1 apply equally for modified E/T/T.

A2.3.7. Recommendations

We recommend that:

(a) there be an income tax deduction by way of special exemption for the year ending 31 March for contributions to a Retirement Income Fund up to a maximum of 20% of a members taxable income;

(b) in an employer subsidised RIF where membership of the RIF is not a condition of employment, the employer is entitled to such percentage of the 20% deduction for a member as the employer pays, and the amount of the contributions made by the employer in respect of that member is to be recorded on the employee's PAYE certificate;

(c) where membership of the RIF is a compulsory term of the employment there must be immediate 100% vesting of the employer's contributions in the member;

(d) any contributions by an employer which are in excess of 20% of an employee's salary are deductible to the employer and subject to FBT;

(e) Section 75(1) of the Income Tax Act should be explicitly made not to apply so as to deem employer superannuation contributions to be income of the employee;

(f) Section 96 of the Income Tax Act should be amended to exclude its application to RIFs where the minimum period for holding the transfer asset or right to income could be breached only on the grounds of retirement or cessation of current employment of a Fund member.

A2.4 Shareholder Employees

The comments and recommendation regarding shareholder employees in Appendix 1, apply equally for modified E/T/T, although if the contributions deduction is by way of special exemption for employers as well as employees, the issues are less significant.

A2.5 Superannuation Fund Net Investment Income

A2.5.1 The Proxy Concept

The proxy concept discussed in both the CD and Appendix 1 (above) is the principle that a Retirement Fund be taxed as proxy for the tax to be paid by fund members.

Under modified E/T/T the proxy concept is the same as for T/T/E. The Fund member pays tax on pension distributions from the fund. However, the present value effect of T/T/E and modified E/T/T is substantially similar on the basis of reasonable assumptions.

A2.5.2 Taxable Revenue and Capital Gains, and Deductible Expenditure, and Corporate Imputation and Superannuation

The discussions and recommendations (except in so far as references are made to the proxy concept) in Appendix 1 Clause A1.6.2, Clause A1.6.3 and Clause A1.6.4 dealing with:

(a) the income of a Retirement Fund that is to be taxed under T/T/E;

(b) the expenditure that is deductible in calculating the assessable income of the Retirement Fund under T/T/E although we recognise that this could lead to the deduction of administration expenses both in the hands of the contributor and the RIF; and

(c) the availability and use of corporate imputation tax credits by Retirement Funds under T/T/E;

are equally applicable to modified E/T/T.

A2.6 Tax Rates

A2.6.1 The CD Proposal and T/T/E

The CD proposal is described in Appendix 1 at Clause A1.7.1.

The proposal for denying a tax deduction to employers and fringe benefit tax for contributions under a T/T/E regime is described in Appendix 1 at Clause A1.7.2. Under T/T/E employers will pay a final withholding tax in respect of employer contributions to a registered Retirement Fund. This last withholding tax proposal is unnecessary for modified E/T/T.

Under modified E/T/T an employer will be entitled to a deduction of up to 20% of an employee's taxable income in any income year, and contributions beyond that amount to be subject to FBT at the normal rate.

A2.6.2 Setting the Tax Rate for a RIF

The discussion in Appendix 1 Clause A1.7.3 for the tax rate for Retirement Funds under T/T/E applies equally for modified E/T/T.

A2.6.3 Recommendations

We recommend that the income of a RIF be taxed at 28%.

A2.7 Benefits, and the Taxation of Benefits, from a RIF

A2.7.1 Previous Position

Benefits taken from a superannuation scheme as a pension have been taxable under Section 65(2)(j) of the Income Tax Act 1976.

Benefits from a superannuation scheme in lump sum form have been regarded as capital payments, and non-taxable.

A2.7.2 Pure E/T/T and modified E/T/T

We have already referred to the fact that E/T/T and T/T/E

produce substantially the same final taxation result in terms of tax revenue received by the Government. The intention in the CD was to move to a non-concessionary taxation regime for superannuation schemes. The E/T/T option is concessionary in the sense that there is a deduction for contributions to a registered Retirement Fund. However the deduction is offset by the taxation of benefits. The Committee considered that the E/T/T option would be more attractive for existing superannuation pension schemes and, if adopted, would lead to fewer of such schemes being wound up upon the introduction of the taxation on fund income.

Under a pure E/T/T environment, all benefits from a Retirement Fund, whether lump sum or pension, would be taxable. In considering the pure E/T/T option, the Committee rejected the idea that there should be compulsory preservation of benefits. That would have been achieved by locking all benefits into a RIF until a member reached the age of eligibility for National Superannuation. Such a course of action would have taken effect from a specified date, by instantly effective legislation, to prevent persons withdrawing from existing schemes, or terminating existing schemes, prior to the implementation date. Under the pure E/T/T tax regime the Committee considered the possibility of pensions being the compulsory form of benefit (without any lump sum entitlement).

The problem was to avoid retrospective "lock in", and yet preserve the existing regime applying to approved pension superannuation schemes as much as possible (and minimise the transition difficulties for such schemes to the RIF regime). The Committee recommends a taxation deduction for contributions to a registered Retirement Income Fund in order to encourage members to remain in an approved pension scheme until reaching eligibility for National Superannuation. Further, and again in the interests of the continuity with the existing tax treatment for pension superannuation schemes, the Committee decided that on the retirement or withdrawal from the RIF, members could cash 25% of their pension for a lump sum. Where the lump sum is taken on or after reaching eligibility for National Superannuation, then it would be tax free to a limit of $75,000. This is the modified E/T/T option.

Under the modified E/T/T option any benefit (other than the preserved cash benefit established at 30 June 1988) paid to the member before reaching eligibility for National Superannuation would be subject to tax in the hands of the member except where the member transfers to another registered RIF.

A2.7.3 Transition to modified E/T/T: Existing Tax Free Lump Sums

An important aspect to the modified E/T/T proposal is the view that there is potential for substantial capital markets disruption caused by wholesale windings-up of existing

schemes. We also wished to avoid retrospective effects. The need to preserve withdrawal and termination tax free lump sums for members of approved pension schemes existing at 30 June 1988 was discussed in Chapter 4 at paragraph 4.2.4. The Committee felt that the removal of the tax free status of lump sums existing at 30 June 1988 would be excessively harsh on members of such schemes, and could be a very considerable incentive on members to withdraw from pension schemes, or for such schemes to be wound up, prior to that date. We summarise the current position below.

> Under the current taxation and superannuation rules, existing trust deeds for approved pension schemes may permit a member to withdraw from the scheme prior to reaching age 50, and that member is then entitled to receive the withdrawal benefits tax free.
>
> A member who withdraws from an approved pension scheme on or after age 50 (or whose pension scheme is terminated on or after the member achieves age 50) is permitted to receive the member's own contributions and interest (or on termination the member's equitable share on the termination less the benefit arising from the employer's contributions) as a tax free lump sum. For a member who retires on or after age 50, 25% of the benefit can be taken as a lump sum. There are also special lump sum rights for persons who previously belonged to lump sum schemes. The balance of the benefit must be taken in the form of a pension which is taxable.
>
> (Many "generous" employers are able to avoid the rules applying to benefits payable to persons aged 50 or over by (1) arranging for the members resignation from their employment immediately before age 50, (2) paying to the member a significant withdrawal benefit, and (3) then re-engaging the member.)

The Committee recommends the following arrangement in order to protect the tax free lump sum amounts that a member would receive upon termination of a scheme on 30 June 1988 or on withdrawal from a scheme on that date.

(a) For members of the Government Superannuation Fund, an amount "W" called the "Specified Cash Benefit" is to be calculated for each fund member as at 30 June 1988, the amount being the member's lump sum entitlement under the Fund if the member was to withdraw from the Fund or retire on that date;

(b) For members of an approved employee pension superannuation scheme an amount being "Specified Cash Benefit" referred to as "W" is to be calculated for each member as at 30 June 1988 as the greater of

(i) the maximum amount which the member could have received as a lump sum if the fund were to be wound up on 30 June 1988; and

(ii) the maximum amount which the member could have received if the member had left the fund by reason of withdrawal or retirement on that date.

[The amounts in (i) and (ii) are to be calculated in accordance with the rules of the superannuation scheme as those rules stood at 31 March 1988; in particular the calculation for members aged 50 or over takes into account the present restrictions on their current entitlements]

(c) the total commuted value of the benefit for each member under the trust deed of the scheme at the time of the members future retirement/withdrawal, or termination of the scheme, shall be called "R".

The Specified Cash Benefit (described in this Clause as "W") is defined under the Retirement Funds Act (see Appendix 5) and the responsibility for calculating the Specified Cash Benefit for each member of a superannuation scheme as at 30 June 1988 is put on to the Trustees of the scheme in that proposed Act. The amount must be identified to the Government Actuary by 31 March 1989, by an interim report.

The maximum amount that may be taken as a lump sum under a RIF is W + 25% of any excess of R over W.

For lump sums taken before entitlement to national superannuation, freedom from tax for lump sums applies up to the amount of the Specified Cash Benefit. For lump sums taken after entitlement to national superannuation, tax freedom applies to an amount up to the Specified Cash Benefit plus $75,000.

A2.7.4 Summary of Recommendations

The recommended taxation position with regard to the lump sum payment is as follows:

(a) for lump sums taken before eligibility to National Superannuation an amount up to "W" is tax free and any balance of the lump sum is fully taxable.

(b) for lump sums taken on or after eligibility for National Superannunation an amount up to "W" + $75,000 is tax free and any balance of the lump sum is fully taxable. Where a person takes lump sums from more than one scheme, the $75,000 applies across all payments.

A2.7.5 Subjecting Benefits to National Superannuitant Surcharge

Any lump sum benefit (except for the lump sum entitlement preserved as at 30 June 1988 and described at Clause A2.7.3 above) taken by a member from a RIF prior to the member acheiving eligibility for National Superannuation will be taxable, so there will be an incentive for a member to remain in the registered RIF until the member reaches that age.

Any taxable benefit received by a member of a registered RIF will form part of the other income of that member for the purpose of the National Superannuitant Surcharge.

A2.7.6 Recommendations

The Committee recommends that:

(a) the benefits from a registered RIF must be taken in the form of a pension except as stated below;

(b) all pensions paid from a registered RIF be taxed in the hands of the pensioner at the tax rate applying to that pensioner;

(c) up to 25% of the value of the pension (to a maximum of $75,000) at the age of the member's eligibility for National Superannuation may be commuted into a tax free lump sum;

(d) a Specified Cash Benefit be identified for each member of an approved employee pension superannuation scheme and the Government Superannuation Fund as at 30 June 1988, and notwithstanding (b) above, that the Specified Cash Benefit be the tax free amount preserved for that member under modified E/T/T on the withdrawal of the member from the RIF or his or her retirement;

(e) responsibility for calculating the Specified Cash Benefit be placed upon the Trustees of every registered RIF by the terms of the proposed Retirement Funds Act such amounts being identified to the Government Actuary by 31 March 1989;

(f) any taxable benefit received by members of a RIF to constitute "other income" for the purposes of the National Superannuitant Surcharge.

A2.8 Amendments to Income Tax Act to Introduce Modified E/T/T

In order to effect the change to a modified E/T/T regime for registered RIFs the following amendments would be required to the Income Tax Act 1976, and taking into account the provisions of the Income Tax Amendment (No. 2) Act 1988.

A2.8.1 Introduction of income tax on the income of the RIF (the middle T)

Section 61(21) Income Tax Act 1976

This section currently exempts from income tax the income derived by the trustee of a superannuation category 1 scheme. The sub-section should be repealed.

Section 225 Income Tax Act 1976

This section currently governs the taxation of superannuation schemes that are not exempted from tax by section 61(21) of the Income Tax Act. The section could be amended to provide for the taxation regime for registered RIFs, for registered RLSFs and for unregistered superannuation schemes.

Section 2 Income Tax Act 1976

This section currently sets out the definitions of superannuation schemes (category 1, category 2 and category 3) and superannuation fund. These definitions would be repealed.

A2.8.2 Introduction of Tax Exemption on Contributions (the First E)

Section 106(1)(m) Income Tax Act 1976

An employer would be able to make a deduction for contributions on behalf of an employee to a superannuation scheme under section 104 of the Income Tax Act, were it not for the effect of section 106(1)(m). Section 106(1)(m) explicitly prevents a deduction from being made under the Act for contributions to a superannuation scheme except to the extent that the Act specifically permits such deductions to be made. Sections 150 and 59 of the Income Tax Act each permit in limited circumstances employer and member deductions in the calculation of the assessable income of those persons.

Section 59 would be amended, and specifically provide for the deduction of amounts up to 20% of a members taxable income in any income year. The current distinction between a special exemption for members and a deductibility provision for employers (in accordance with normal income tax principles) would be abolished.

Section 150 Income Tax Act 1976

This section currently provides for employer deductions for amounts contributed to a subsidised employee

superannuation scheme, the maximum deduction being an amount equal to 10% of the employers annual salary payments to employees who are members of the scheme. The section would be repealed.

Amendment to Fringe Benefit Tax Provision

Amendment to effect an exemption of up to 20% of an employee's taxable income paid by an employer would be required before fringe benefit tax applied to employer contributions.

Section 59 Income Tax Act 1976

This section currently contains the special exemption for contributions to registered superannuation schemes. A special exemption is required for these contributions because, from a member's perspective, such contributions are not a business or employment related expense. The treatment of employee contributions as a special exemption could be retained under E/T/T. Employer contributions would also be dealt with as a special exemption under section 59.

Where any benefits have been paid from the RIF prior to the member reaching the age of eligibility for national superannuation, there shall be no exemption for any contributions in respect of the member to a registered RIF for three years following the year of receipt of the benefit.

A2.8.3 Taxation of Pension Payments (the final T)

At least 75% of the benefit from a registered RIF must be in the form of a pension. Pensions are already assessable under section 65(2)(j) of the Income Tax Act. The sub-section should be amended to catch as income any benefits paid under a registered RIF in excess of the tax free lump sum permitted by the Act (which matter is dealt with in A2.8.4 below).

A2.8.4 Tax Free Lump Sum

Superannuation schemes that are currently approved as pension schemes may permit the commutation of up to 25% of the pension payable upon retirement of the member into a tax free lump sum.

Under modified E/T/T the right to permit commutation of 25% of the pension will be maintained.

At present the tax free status of the lump sum derives from the traditional distinction between capital and income, the lump sum being regarded as a capital payment and therefore non taxable. The Committee

suggests that the capital nature of that lump sum payment be entrenched by way of a specific amendment to section 61 of the Act (the section dealing with incomes wholly exempt from tax). The exemption should also refer to the preserved tax free lump sum for members of schemes as at 30 June 1988.

A2.8.5 Other Sections to be considered

The effect of the following sections need to be considered in light of the modified E/T/T regime that will apply for registered RIFs:

- Section 149 of the Income Tax Act dealing with contributions to employees benefit funds;
- Section 151 of the Income Tax Act dealing with the deductibility of pensions payable to former employees;
- Section 152 of the Income Tax Act dealing with the deductibility of retiring allowances payable to employees;
- Section 153 of the Income Tax Act dealing with the deductibility of payments to employees or former employees while on naval, military or air service.

A2.9 Relationship Between E/T/T Regime and State Targeted Income Support Measures

The comments and recommendations made in Appendix 1, Clause A1.9 partially apply for T/T/E and modified E/T/T.

A2.10 Miscellaneous Considerations

Appendix 1 at Clause A1.10 deals with three particular issues namely:

(a) provisional tax rules for Retirement Funds;

(b) the tax treatment of clawbacks of excess contributions by employers to subsidised Retirement Funds; and

(c) whether an imputation scheme for Retirement Funds would be possible whereby the benefit could be taxed in the members hands and offset by an imputation credit tax already paid by the Fund on its income.

The discussion and recommendations relating to provisional tax, clawbacks and an imputation scheme for Retirement Funds in

Appendix 1 are applicable for T/T/E and modified E/T/T (except that under modified E/T/T the employer contributions should be included in the Retirement Funds provisional tax because there will be no final withholding tax payable by the employer on employer contributions under modified E/T/T, and clawbacks will be taxable in the employer's hands).

A2.11 Summary of Recommendations

The Committee recommends that:

a **E/T/T be the new regime for long term retirement (pension) income savings;**

b **T/T/E be the new regime for retirement lump sum savings;**

c **E/T/T should have a limit for tax deductibility of contributions by contributors, whether they be employers, employees, self employed or people who contribute outside of an employment relationship;**

d **tax deductibility for all contributions be deal with by way of special exemption;**

e **E/T/T should have no fringe benefit tax levy in relation to employer contributions up to the tax deductible limit for the contributions paid by the employer;**

f **E/T/T should provide for**

- **preservation, in the sense that the proposal requires a pension income stream, and benefits taken in any other form before eligibility for National Superannuation will be fully taxed, apart from current existing cash benefits preserved at 30 June 1988; and**
- **portability, so that employees can transfer contributions from one registered RIF to another without being subject to tax;**

g **pension schemes governed by E/T/T should have a separate and new statutory regime, which we have called a Retirement Income Fund or RIF;**

h **lump sum schemes governed by T/T/E should have a separate and new statutory regime, which we have called a retirement lump sum fund or RLSF;**

i **all existing superannuation schemes which are registered under the current legislation should be given interim registration and thereafter compliance should be mandatory to 31 March 1990;**

j all RIFs and RLSFs should have a standard form of trust deed;

k to prevent abuses known under the present superannuation structures, there need to be rules preventing "back to back" loans and other non arms length avoidance arrangements.

APPENDIX 3 - RE-NEGOTIATION OF SUPERANNUATION SCHEMES

A3.1 The Need For Re-negotiation of Benefits and Contributions

The most significant change in the income tax regime for superannuation schemes is the introduction of taxation on fund income. To date such income has been exempt from tax (except for schemes caught by section 225 of the Income Tax Act 1976). The effect of the introduction of tax upon fund income will be to reduce the amount of money in the fund from which contracted benefits can be paid. Also, under T/T/E, there is the substantial change of switching tax from benefits to contributions. Accordingly, benefits and contribution levels will have to be re-cast for existing schemes to take account of these factors. We discuss the issues below.

A3.2 The CD's Re-negotiation Approach

Section 7.10 of the CD states:

> "The changes to the taxation of superannuation will require schemes to consider re-negotiating their terms. This is because benefits may have been promised, or may be being provided, on the basis that the superannuation scheme is tax-exempt."

The CD goes on to state:

> "To allow this to occur in a smooth manner which is fair to all concerned, where the change in tax regime makes changes to the terms of a scheme's trust deed necessary, approved superannuation schemes will be required to secure the agreement of a majority of scheme participants to new terms. That agreement will need to be lodged with the Government Actuary by 1 July 1989. The Government Actuary will be empowered to decline to approve the new terms if the amendments are not equitable."

A3.3 Comment

Re-negotiations will involve interaction between members and employers. However, the trustees have the responsibility for ensuring the fairness of the final scheme modifications. Because re-negotiation involves questions of reductions in members' expectations, in most cases it will not be possible for the trustees to obtain the approval of even the majority of members.

The Committee believes that the final decisions on re-negotiation will need to be left to the discretion of the trustees, acting in the interests of the members as a whole, having received professional advice. As a final check upon the equity of the revision of the scheme, the Government Actuary

will be empowered to approve or disapprove the proposed revision.

The Committee also agrees with the many submissions which protested that the date of 1 July 1989 gives too short a period for the proper consideration of the complex issues involved. Accordingly, a date of 31 March 1990 has been set instead.

The CD proposed, for a T/T/E regime, that pensions should only be tax free from the earlier of 1/4/89 and the date the Government Actuary approves the amendment to the scheme. The Committee considers that the linkage between tax freedom of pensions and re-negotiation within this time frame is unworkable. It therefore proposes that all pensions be tax free as from 1 April 1989.

A3.4 The CD's "Equitable Basis" Approach

In referring to an equitable basis for re-negotiation, the CD stated:

> "There will be a presumption that an equitable basis will be one in which, calculated using any reasonable actuarial basis, the increased tax burden resulting from the removal of tax privileges falls on all members and beneficiaries as if their current proportion of the fund were distributed tax-free and then re-invested in the scheme under the new rules. If all informed parties agree to a different outcome, the approval of the Government Actuary to the amendments will be forthcoming."

A3.5 Discussion

The Committee considers that the basic practical problems with re-negotiation will arise in defining the benefits which will have accrued to individual members at the revision date of the scheme. In considering this matter, it is necessary to draw a distinction between Defined Contribution and Defined Benefit schemes.

A3.5.1 Defined Contribution Schemes

The effect of a "taxed/taxed/exempt" or "modified exempt/taxed/taxed" tax regime will not affect benefits which have already accrued except to the extent that pensions are currently being paid under the scheme.

If no such pensions are being paid, the sponsors and trustees will not need to consider reducing benefits which have already accrued to the scheme revision date.

If such pensions are being paid, the Committee considers that the surplus in the scheme's Reserve Fund should be used to maintain at least the net-of-tax pension receivable by each pensioner at the level which existed immediately prior to the scheme revision date.

If the surplus is not sufficient to do this, the Committee considers that the trustees should bear in mind the two possible options indicated below for Defined Benefit schemes.

Many pensions arising from Defined Contribution Schemes are in the form of annuities purchased from Life Insurance Companies. Re-negotiation of these contracts will be considered in our report on Life Insurance Companies.

A3.5.2 Defined Benefit Schemes

Such schemes provide promised benefits, and such promises were made on the basis of a particular tax regime. Changes in the tax regime have implications for members accrued benefits.

The issues involved here are significantly more complex. There is no one solution which will provide an equitable result for all schemes. The Committee consider that there are two basic approaches to what constitutes an equitable basis. These are:

A3.5.3 Options

Option 1
This is the approach suggested in the CD viz. to value each member's accrued benefits in a scheme on a "wind-up" basis, and then determine the level of benefits this dollar amount can purchase in future under the new tax regime.

The definition of "accrued benefits" has been subject to legal and actuarial argument. To avoid possible misinterpretation and to ensure uniformity of treatment for all members of all superannuation schemes, the Committee expects that the definition of "accrued benefits" in the draft legislation attached to this Report shall be used for all scheme revisions.

Option 2
To reduce all member's benefits by the same percentage to reflect the increase in costs involved under the new tax regime.

Each of the two options mentioned above has its own advantages and disadvantages.

A3.5.4 Discussion of Options 1 and 2

Option 1
This approach requires the assumption to be made that it is reasonable to allocate the assets between members of what has always previously been assumed before to be an unallocated

scheme. The advantage with this step is that it produces a similar overall result in terms of benefits to a member in the future as is the case under a defined contribution scheme.

The approach recognises the fact that a scheme could be wound up and the assets allocated to members.

However, the approach has the distinct disadvantage that the new benefit levels will vary for each member dependent primarily on the member's age. Whilst this will be equitable on a "present value" basis, it might not appear to be equitable to individual members.

Option 2
The advantages and disadvantages of this option are really the converse of those under option 1.

From most members' viewpoint the approach would appear to be equitable, as all members would lose the same percentage amount. However, some members would be clearly disadvantaged. For example, a member who is just about to retire and receive a payment from a lump sum superannuation scheme would have his benefit reduced even though the scheme had in effect put aside for him the original benefit level.

On the other hand, this approach recognises that defined contribution and defined benefit schemes are completely different types of schemes, and that the latter type do operate such that the money in the scheme is not allocated to each member.

A problem with this approach is that the reduction for individual schemes will not be uniform: it will vary depending on such factors as age profile and salary levels.

A3.6 Discussion of Actuarial Basis used in revision of Defined Benefit Schemes

The Committee has considered the possibility of legislating an actuarial basis for use in the revision of defined benefit schemes. The Committee is concerned that some companies which are experiencing cash flow problems, either in respect of their New Zealand or overseas operations, may wish to attempt to carry out an asset-stripping exercise on the company's superannuation scheme under the guise of "revising"the scheme's benefits. Such an exercise would involve the use of an over-optimistic actuarial basis for valuing the liabilities to pay the benefits, thus resulting in the disclosure of a "surplus" which the company would seek to recover for its own use.

The Committee considers that it is not possible to legislate for an actuarial basis which would be equitable for all schemes - because the demographic and financial factors can and do vary between schemes; investment performance is but one example.

However, the Committee recommends that the Government Actuary publish an actuarial basis in one of his Information Letters which are circulated to professionals involved in the superannuation area. The Committee suggests that the Government Actuary require figures to be supplied to him on this basis prior to agreeing to any revision of a defined benefits scheme, regardless of whether that published basis is the one which was used in determining the revised scale of benefits. In addition, the Committee suggests that the Government Actuary require any departure from his published basis to be justified by reference to circumstances peculiar to the particular scheme.

The Committee believes that the publication of its concerns in this area, together with the suggested action by the Government Actuary and the limitation of acceptable reports to actuaries who are fully conversant with New Zealand conditions, will prevent the type of raiding of the funds of superannuation schemes which has occurred overseas.

A3.7 Summary of Recommendations

The Committee recommends that:

(a) the time for re-negotiation of schemes be extended to 31 March 1990;

Minister's decision: Agreed.

(b) the Trustees acting in the interests of the members affix the new benefit levels under the supervision of the Government Actuary;

Minister's decision: Agreed. Where possible, the renegotiation of schemes and benefit levels is desirable. The guidelines will stipulate that the Government Actuary's approval will be dependent upon the after-tax pensions of those New Zealand resident scheme members who are in or near retirement being maintained wherever possible.

(c) that tax freedom of pensions under a T/T/E regime not be dependent on scheme re-negotiation and that it should apply from 1 April 1989;

Minister's decision: The tax on superannuation scheme pensions will be removed from 1 April 1990 with schemes being required to obtain Government Actuary approval before paying adjusted pensions. The Committee has recommended that schemes be given until 31 March 1990 to adjust scheme benefits. Removing the tax on pensions from that date will ensure that the two adjustments to pensioners' net incomes can take effect from the same date thus avoiding unnecessary fluctuations in the net

incomes of pensioners. This will also help to reduce the windfall gains which will accrue to many existing pensioners under this reform and which were a source of concern to the Committee. It is important to note that the funds being withdrawn from pension schemes in 1989/90 will have accumulated under an Exempt/Exempt/Taxed regime. Retaining the tax on pensions for a further year does not, therefore, raise concerns about double taxation. Provision for the removal of this tax will be included in legislation to be introduced later this year.

(d) guidelines be published by the Government Actuary to cover the actuarial basis to be used in the re-negotiation of benefits and that such guidelines must be followed by all Trustees of superannuation schemes unless departure can be justified to the Government Actuary's satisfaction;

Minister's decision: Agreed.

(e) the discussion of the Committee contained in A3.6 of this appendix be published so as to alert members of schemes to the matters raised.

Minister's decision: Agreed.

APPENDIX 4 - REGISTRATION AND REGULATION

A4.1 Introduction

A4.1.1 Registration and Regulation

In considering the question of regulation, the first issue is whether any is needed at all. Our view is that, on balance, it is necessary to have a regulation system, because:

(1) There is a potential for tax abuse, largely arising from the differential rate structures in terms of individuals and companies; and

(2) Prudential supervision is desirable. We see retirement savings funds as being in the same category as for ordinary savings institutions such as trading banks.

A4.1.2 Outline and Summary of Appendix

Under both Taxed/Taxed/Exempt (T/T/E) and modified Exempt/Taxed/Taxed (E/T/T), there is a need for a revision of the present superannuation registration and regulation regimes. We propose

- a single new Act (broadly the terms of which are applicable to both T/T/E and E/T/T). The proposed new Act together with an explanatory note as to the source of the provisions in that proposed new Act are annexed in Appendix 5;

- a new standard form of trust deed, the terms of which will be effectively mandatory (and applicable to both T/T/E and E/T/T). The standard form of trust deed is part of the proposed Act, its terms are part of the Act, and it appears as the First and Second Schedules to the Act;

- that pension schemes under the proposed Act will be called Retirement Income Funds ("RIFs");

- that lump sum schemes under the proposed Act will be called Retirement Lump Sum Funds ("RLSFs");

- a new prudential - supervisory role for the Government Actuary (applicable to both T/T/E and E/T/T);

- mandatory reporting to members, and more detailed audit requirements (applicable to both T/T/E and E/T/T);

- a statutory minimum of one member trustee for each registered RIF and for each registered RLSF (applicable to both T/T/E and E/T/T).

A4.1.3 Summary of Regulation of Proposed Retirement Funds

The detail of the **scheme of regulation** for Retirement Funds that we recommend is described below. In essence the

scheme is as follows:

- the Government Actuary will be <u>empowered</u> to permit departure from the standard form in circumstances where such departure:

  - is fully disclosed and explained by solicitors' certificate to the Government Actuary; and

  - the Government Actuary forms the opinion that such amendment does not breach the terms of the Act and is necessary or desirable for the purpose of expeditious administration of the RIF and does not have the effect of abusing the controls and policy of the legislation. Our view is that the standard form of deed we have prepared will meet the vast majority of cases, if not all of them. There may be cases which warrant a departure, and to enable some limited flexibility, we have provided for it.

- existing approved superannuation schemes will be required to convert to the Retirement Funds regime, and standard form of Deed.

- for a pension scheme to qualify for the E/T/T taxation benefits we recommend, the pension scheme must be registered as a RIF in an approved form under the Act with the Government Actuary;

A4.1.4 Discussion of Standard Form Deed

In recommending a standard form of Retirement Fund Deed (for both RIFs and RLSFs), our purpose is to ensure that the Government Actuary is no longer in the position of having to check every single trust deed to ensure compliance with the present legislation. It simply will not be possible for solicitors, actuaries, and financial advisors, to continue to exploit the present position by drafting documents which do not clearly identify the purpose of a particular clause, in the hope that it will escape unnoticed.

A4.1.5 Consultative Document

For a number of reasons, we broadly accept the argument in Chapter 5 of the CD that the present structure of superannuation schemes for tax purposes gives rise to tax preferences which are enhanced by various tax planning techniques.

Our view is that the possible level of abuse under the revised regime in New Zealand can now be controlled within a sensible, practical, administrative regime.

<u>Appendix 5</u> to our Report contains the draft legislation, the draft standard trust deed, and an explanatory memorandum.

A4.2 Present Regulatory System

A4.2.1 Present Position

The present regulatory system for superannuation schemes is contained in the Superannuation Schemes Act 1976 and the Superannuation Schemes Regulations 1983. Part I of that Act deals with the dissolution of the New Zealand Superannuation Scheme and the New Zealand Superannuation Corporation.

Part II of that Act deals with the approval and classification of superannuation schemes and provides a broad executive regulation making power to cover the detail of scheme regulation. Currently the constitutional documents of superannuation schemes are presented to the Government Actuary for approval and classification as:

(a) an employee pension superannuation scheme (and whether or not it is a subsidised scheme);

(b) a personal pension superannuation scheme;

(c) an employee lump sum superannuation scheme (and whether or not it is a subsidised scheme);

(d) a personal lump sum superannuation scheme.

Part III of that Act deals with miscellaneous provisions relating to the variation of trust deeds and other matters.

A4.2.2 Comment

The classifications under the Superannuation Schemes Act are of particular significance in the context of the taxation regime for superannuation schemes existing prior to 17 December 1987. Those detailed classifications will be unnecessary under the new taxation regime for superannuation.

If there is a modified E/T/T regime, there will be two classifications for superannuation schemes - pension schemes and lump sum schemes.

We propose use of the new terms "Retirement Funds Act, Retirement Funds, Retirement Income Funds, and Retirement Lump Sum Funds" to replace the present terminology relating to superannuation schemes to emphasise the change from the present superannuation regime.

Registration of superannuation schemes by the Government Actuary will be for prudential supervision. The Committee considered that the regulation and particularly the financial reporting requirements for trustees of superannuation schemes required to be upgraded. Further the Committee decided that it was simpler for the detail of the regulation of superannuation schemes to be contained in one Act rather than

being split between an Act and Regulations as is currently the case.

A4.2.3 Recommendations

The Committee recommends that Parts II and III of the Superannuation Schemes Act 1976 and the Superannuation Schemes Regulations 1983 be replaced by a new Retirement Funds Act.

A4.3 Summary of Features of Proposed Regulatory Regime

A4.3.1 There are six essential parts to the new regulatory regime we propose, as follows:

- To define the special role of member trustees.
- To define the role of the Government Actuary.
- To define the role of the Auditor.
- To define the role of the Trustees' Report to Members.
- To define the role of the trust deed.
- To define the role of actuaries and solicitors in scheme design.

A4.3.2 In relation to each of these matters, we give details of our reasoning under the separate headings below.

A4.4 Special Role of the Member Trustee

A4.4.1 Present Position

Presently there are no restrictions as to the composition and number of trustees of an approved superannuation scheme. In many employer/employee superannuation schemes the trustee is the employer.

A4.4.2 Comment

Recently in the context of companies which have gone into liquidation, there has been publicity about members' contributions (and the employers' contributions) that have been collected by the employer but have not been paid to the superannuation scheme. There are often timing delays in the collection of member contributions by an employer and the payment of such contributions into the superannuation scheme. We believe members ought to know about that. Delay in providing that information, perhaps up to a year later, is probably detrimental to members' interest.

The Committee considers that the problems referred to above would be less likely to occur if one of the trustees of the scheme were to be a member of the scheme. Member trustees could represent the interests of the members of the scheme in the decisions to be taken by the trustees relating to the scheme. The proposed Retirement Funds Act annexed provides that at least one trustee of every registered Retirement Fund must be a member of that Fund.

The member trustee will be in a position to police the payment of all contributions to the Retirement Fund. The member trustee should be sensitive to the interests of the members of the Retirement Fund, and will be in a position to encourage proper levels of communications between the trustees and the members of the Retirement Fund.

A4.4.3 Recommendation

We recommend that at least one member of the Retirement Fund be a trustee of that Fund.

A4.5 Role of the Government Actuary

A4.5.1 Present Position

Presently, the role of the Government Actuary is substantially confined to the approval of trust deeds. In addition, there is a role in ensuring that approved schemes file accounts and make reports within the present rules.

A4.5.2 Comment

The role of the Government Actuary should go much further. Given the basic similarity of the great number of deeds, we see little point in the Government Actuary's office spending the time and resources presently required in checking each new form of trust deed submitted for approval. There are now substantial delays in this process. A standard form would remove this almost completely.

A4.6 Prudential Supervision by the Government Actuary

A4.6.1 Some of the Policy Issues

Retirement savings give rise to issues concerned with certainty of payment of the benefits. Many submissions stressed the importance of the certainty of contracted benefits. Whichever regime is adopted by the Government - T/T/E and/or E/T/T - the need for certainty of payment gives rise to a number of important policy issues:

> Should the Government "underwrite" or "guarantee" the solvency of a registered Retirement Fund, to ensure

that the contracted benefits, if any, are actually capable of being provided by the Retirement Fund?

- If the answer to that question is, "No", what responsibility does the Government have - in addition to the trustees - to provide a level of prudential supervision of Retirement Funds?

- Should employee contributors be provided with any kind of statutory mechanism whereby they are alerted to possible bad management of a Retirement Fund at the earliest time?

A4.6.2 Discussion

In the light of the present Government's policy concerning financial intermediaries generally, we do not argue the case for an "underwriting" or "guarantee". We appreciate that the Government is actively working to remove government guarantees of financial institutions. In addition, the prudential supervision of financial institutions by the Reserve Bank of New Zealand plainly does not underwrite or guarantee the security of savings with them.

We do not consider it appropriate that people who "invest" in a Retirement Fund should be in a preferred position from those who choose to invest in a bank, for example, if the defaults where to occur.

Nevertheless, we believe that there is a role for the prudential supervision of Retirement Funds. Just as the Reserve Bank has that responsibility in relation to financial institutions, and requires regular reporting to keep itself properly informed, so we think a similar regime is desirable in terms of the Government Actuary and Retirement Funds.

Perhaps a better analogy is the well known commercial practice in relation to debenture stock trust deeds, which offer varying levels of security in relation to borrowings undertaken by companies. Some such deeds do not "secure" the assets of the borrower at all, but instead provide for a series of promises about financial ratios, which the borrower covenants that it will maintain. In the event of failure to maintain the agreed ratios, there is an event of default, and the trustee can appoint a receiver. Regular reports are required of the borrower about its financial position, and such reports are often also required to be supported by certificates from the borrower's auditors.

We favour such a regime for registered Retirement Funds where the Government Actuary has powers similar to those of the trustee under a debenture trust deed. We do not consider that the Government Actuary should be responsible for "guaranteeing" solvency. But we do think that if the Government Actuary becomes dissatisfied with the ability of

the Retirement Funds to provide the contracted benefits or is concerned about the stewardship of the moneys and investments, he ought to be able to do something about it, for two reasons.

(a) First, if people continue to contribute to such Retirement Funds, in effect they could be paying "good money after bad" in ignorance. This is the same idea as applies to continued lending to a financial institution that is, in fact, insolvent.

(b) Second, trustees and auditors should focus on the ongoing viability of whatever Retirement Fund is offered. (This is the same idea as applies to financial institutions under the prudential supervision of the Reserve Bank.)

It follows that where the Government Actuary is not satisfied about the continued viability of a particular Retirement Fund, he ought to be in a position to do something about it at an early stage. That makes the form of the scheme reporting function essential, and it requires the Government Actuary to be given quite wide powers. These include the dismissal of trustees, and a form of statutory management of a non-complying Retirement Fund. Our view is that the function of a receivership is a valid analogy, and we have therefore adopted it.

As drafted, where the Government Actuary determines that a Retirement Fund is no longer viable, his powers involve the following:

- informing members, including calling meetings of members

- receivership of the existing Retirement Fund, and separation from it of any further contributions from the date of receivership;

- immediate advice to existing members of that position;

- the orderly liquidation of any remaining assets in the Retirement Fund, and/or their transfer to another registered Retirement Fun. Any loss of entitlement lies where it falls, in terms of the membership of the now defunct Retirement Fund.

Alternatively, the Government Actuary may decide that the Retirement Fund in receivership is viable, if certain management steps are taken. In that case, there would be no need to terminate the particular Retirement Fund, so long as viability was reached within a short period of time. For example, the level of contributions may be in arrears, or contributions may be inadequate for defined benefits. In such case, there may be a need for renegotiation or a "top up", but there cannot be an inordinate length of time involved. Our

view is that the relevant corrective action must have been taken within one year of the receivership occurring.

A4.6.3 Recommendations

We recommend that:

(a) The role of the Government Actuary be that of a "public watchdog", akin to a statutory trustee for members, with powers to ensure compliance and to maintain solvency;

(b) In order to discharge that role, the Government Actuary should have the power to effect a receivership of a registered Retirement Fund, and, if necessary, to order its winding up and the transfer of assets to other registered Retirements Funds.

A4.7 Role of the Auditor

A4.7.1 Present Position

The present position regarding the role of the auditor and the general auditing function are loosely defined in the present Act.

A4.7.2 Comment

The Committee decided that the role of the Auditor should be more carefully described under the new regulatory regime. One basic role that the Auditor has is to report whether the accounts give a true and fair view at balance date of the state of affairs and of the financial results of the Retirement Fund. We think that is desirable.

We also consider that it is really only the Auditor who is in a position, in practical terms, to check on compliance with the investment rules we propose. It cannot be the Government Actuary, simply because of the lack of resources. Auditors can and do perform a valuable compliance function. If unauthorised investments have been made, or if the trustees have not properly complied with the terms of the trust deed, the Auditor ought to be in a position to say so in his or her report to the Trustees. That report must also be forwarded to the Government Actuary and to the members.

A4.7.3 Recommendations

We recommend that:

(a) the present role of the Auditor needs to be extended for compliance purposes;

(b) the Auditor report on whether or not proper books and records have been maintained by a Retirement Fund and that the annual accounts of the Fund have been properly prepared in order to give a true and fair view of the balance sheet and revenue statement (or statement of Fund transactions);

(c) the Auditor report on whether or not the investment and borrowing activities are in breach of the trust deed and this Act and whether or not the Retirement Fund is being operated in terms of its Trust Deed and the Act.

(d) the Auditor signing the Audit report must be the holder of a Certificate of Public Practice issued by the New Zealand Society of Accountants.

A4.8 Role of the Trustees' Reports to Members

A4.8.1 Present Position

Currently Trustee reports to members often contain insufficient financial and other information to be of much use even if such reports are made at all. Also the Trustee's reporting function is directed at reporting to the Government Actuary rather than to members.

A4.8.2 Comment

The Committee considered that the Trustee's Report to members regarding the Retirement Fund should be upgraded. To carry the analogy of the debenture trust deed a step further, potential debenture stock holders obtain financial information regarding the Company in which they will invest (or have invested) from the prospectus pursuant to which debenture stock is offered for subscription. Instead of having a prospectus for registered Retirement Funds, the Trustees of the Retirement Fund will be required to provide detailed financial information relating to the Retirement Fund to persons prior to their entry into the Retirement Fund, and to members not later than 3 months after the end of the Retirement Funds financial year, and also on request by members.

A4.8.3 Recommendation

The Committee recommends that more detailed information be contained in the Trustees' Report to members, the detail being that set out in clause 5 of the proposed Retirement Funds Act (see Appendix 5).

A4.9 Role of the Trust Deed

A4.9.1 Present Position

Under the Superannuation Schemes Act 1976 a superannuation scheme submitted to the Government Actuary for approval and classification is required to have a trust deed or other constitutional instrument. Responsibility for the preparation and content of that instrument is left to the parties establishing the superannuation scheme.

A4.9.2 Comment

The Committee decided that a great deal of time, effort and money has been ineffectively used in relation to the preparation of various different trust deeds. Many of the provisions were motivated to achieve specific taxation advantages under the old tax regime for superannuation. The sterility of these efforts on the part of scheme designers is readily apparent.

Appendix 5 to our Report contains the draft legislation, the draft standard trust deed, and an Explanatory Memorandum. The suggested standard form of trust deed (and its standard provisions) is effectively mandatory. Any alteration to the standard form and standard provisions must be made to an executed Trust Deed, and then submitted to the Government Actuary with an explanation as to the reason for the alteration. Deviation may only be permitted by the Government Actuary if it can be demonstrated that the standard clause is deficient in some regard.

In terms of the standard form we have prepared, the only matters to be settled between employer and employee are:

- membership rules
- the level of contribution, and who is responsible for making them
- the benefits that are defined
- the number, appointment and retirement of Trustees.

All existing superannuation schemes that are approved under the Superannuation Schemes Act 1976 shall be granted interim registration under the proposed Act until 31 March 1990. The renegotiation of benefits and contributions is to be undertaken during that interim registration period. All such existing superannuation schemes shall then apply for registration under the proposed Act (before 31 March 1990), and shall have the new mandatory trust deed.

A4.9.3 Recommendations

We recommend that:

(a) there be a mandatory form of trust deed for all Retirement Funds;

(b) any change to the mandatory form of trust deed will be ineffective without the Government Actuary's specific approval to the change (which change is to be brought to the Government Actuary's attention by the solicitor's certificate discussed in A4.10 below);

(c) the only real issues for negotiation between employer and employee in the construction of the trust deed are as to

- membership of the Retirement Fund,

- the contribution rules of the Retirement Fund,

- and the type of benefit offered by the Retirement Fund.

Those are properly matters of contract.

A4.10 Role of Solicitors and Actuaries in Scheme Design

A4.10.1 Present Position

Presently actuaries and solicitors are involved in the basic design of superannuation schemes, and many have been particularly interested in exploiting the taxation advantages.

A4.10.2 Comment

We can see little future role for solicitors and actuaries in drafting elaborate trust deeds. The main role we envisage is to design benefits, and contributions. Obviously, because of the different types of scheme that are available, and which will continue to be offered in the market, benefit design will continue to be very important.

A solicitor's certificate will be required when a deed is submitted to the Government Actuary for approval. In this way, there will be greater disclosure in relation to particular clauses differing from the standard and their purpose. We think that this is an important feature to ensure greater compliance, and to lift the burden from the Government Actuary.

The Committee considered whether it was necessary to provide an exclusive function for solicitors with regard to the preparation of the trust deed. A trust deed in the context of a Retirement Fund is an important constitutional document establishing a trust relationship, under which large sums of money may be held, managed and distributed. The Committee wishes to reduce the abuses that existed under the superannuation schemes regime in the construction of trust deeds. Our conclusion is that responsibility for the certification of trust deeds for Retirement Funds should be undertaken by senior solicitors. This approach will shift the compliance onus from the Government Actuary, and lead to a freeing up of resources in relation to the proposed prudential role we have recommended.

A4.10.3 Recommendations

We recommend that:

(a) a solicitor should provide the Government Actuary with a solicitor's certificate that the Retirement Fund's trust deed (already executed) is in compliance with the Act, and if there is a proposed variation from the standard form, the solicitor's certificate must draw attention to it, and its intended purpose. The Government Actuary will be obliged to consider whether or not to approve such a change and the alteration will not be effective until it is approved;

(b) the solicitor giving the certificate must be a principal of a firm of legal practitioners or a sole practitioner, and must hold a current practising certificate.

A4.11 Limit on Investments of RIF and RLSF Funds

A4.11.1 Present Position

The present investment powers of the trustees are set out in Regulation 10 of the Superannuation Schemes Regulations 1983.

A4.11.2 Comment

We are concerned by the abuse that has arisen in terms of contributions which have been made to some types of scheme, typically close to the end of the tax year, which moneys have miraculously been re-advanced to the contributor shortly after the commencement of the next income tax year.

We are also concerned about the possibility for a RIF to make certain types of investments with an employer which are not at arms-length because of the relationship between members and the employer. Also, we see no reason why, from the point of

view of investor protection, the same requirements should not apply to RLSFs (which are not protected by Securities Legislation).

In our view, if there is to be a long term retirement savings plan recognised by the Government for that purpose, the funds contributed and earnings of the Retirement Fund must be kept at arms-length from all contributors at all times; and that Retirement Funds should be subject to some investment rules in order to protect the members of such Funds against poor investment practices by Trustees.

Our proposal may be seen to be something of an over-reaction, but without the investment limitations we propose, we could see the continued presence of tax planning arrangements which would ultimately defeat the purpose of the Retirement Income Fund proposal and have serious revenue implications.

A4.11.3 Recommendations

We recommend that:

- **(a) arms-length investment terms be mandatory;**
- **(b) there be a specific limit on the amounts which can be invested in employer and member offered securities.**

A4.12 RIFs and Other Investment Funds

Under our proposal, a RIF can be operated in several different ways. An individual could operate his or her own RIF. So long as there was compliance, we see no difficulty in such an arrangement.

An individual could also join any number of registered RIFs. This would involve spreading risks, and could involve investments in different types of RIF operated by a single institution, or by a number of different institutions or fund managers. The point is that we consider that any RIF should "stand alone" in the sense that the funds cannot be mixed with another type of fund. To be specific, in order to maintain competitive neutrality in the market place, our view is that a Life Insurance Fund should not be allowed to mix with a RIF. We see no reason why a life office could not offer a RIF scheme, so long as it was separately provided for and independently managed. This would not preclude part of the investments of a RIF being in banks, life offices and other financial intermediaries.

A4.13 Non Employer Related RIFs

So far, in this Appendix, we have generally concentrated on

the traditional employer related contribution schemes. Of course, there are numerous schemes which are independent of employers. Typically, these have been personal schemes, and many are marketed by financial intermediaries such as Life Offices.

In this regard, we can see no reason for personal schemes to be affected by our proposal. Such personal schemes, no matter who operates them, if they are to enjoy the benefits of the RIF regime we have proposed, will have to adopt the standard form of trust deed, and conform to the requirements in terms of disclosure, audit and so on.

A4.14 Transition Issue - Whether there should be a requirement for existing schemes to convert to the proposed new Rules

A major part of the proposal is the use of a standard form set of rules. There are now several thousand registered schemes, under the Government Actuary's supervisory function. Our view is that all existing schemes should be required to conform to the proposed new standard form.

In order to obtain a sensible transition, interim registration for all schemes currently approved by the Government Actuary would be conferred under the new Act and will last until 31 March 1990. As of that date a transitional registration under the RIF and RLSF proposals would cease, unless the new regime has been adopted by the trustees of the RIF/RLSF and their members.

We have considered the question of conversion for existing schemes carefully. Ultimately, the desirability of conversion being made initially compulsory rests on a judgement as to whether or not it will reduce compliance costs in the long run. A virtually mandatory form of standard deed has a compelling simplicity. In time, the need for the Government Actuary, and Auditors, to consider compliance issues must be reduced if a standard form were adopted. That reduces compliance costs, and also reduces opportunity costs in terms of precious resources. The ability of the Government Actuary to exercise the level of prudential supervision we envisage for both RIFs and RLSFs fundamentally depends on shifting the focus of his enquiries. Our view is that a standard form for every Retirement Fund will significantly free up resources to this end.

A4.15 Amendment to Other Non-Tax Legislation

The reference to approved superannuation schemes contained in the Securities Act will require amendment to refer to registered Retirement Funds.

There may also be other references in other legislation which have not been identified.

A4.16 Accounting Standards

In order to improve the quality and uniformity of reporting, we have invited the New Zealand Society of Accountants to issue a statement of accounting practice suitable for use by Retirement Funds.

A4.17 Summary of Recommendations

The Committee recommends that:

(a) **there be a new Retirement Funds Act;**

(b) **all existing approved superannuation schemes be given interim registration to 31 March 1990 under the new Retirement Funds Act while the contributions and benefits under such schemes are revised and full registration under the new Act is obtained;**

(c) **there be a standard form of trust deed for all registered Retirement Income Funds and Retirement Lump Sum Funds which standard form trust deed shall be adopted by all Retirement Funds registered under the new Retirement Funds Act;**

(d) **there be a new prudential-supervisory role for the Government Actuary with regard to Retirement Income Funds and Retirement Lump Sum Funds;**

(e) **there be mandatory reporting of financial information relating to the Retirement Fund (RIF and RLSF) to members;**

(f) **there be more detailed audit requirements for Retirement Funds (RIFs and RLSFs);**

(g) **there be at least one fund member who is a trustee of the Retirement Fund (RIF and RLSF)**

(h) **arms-length investment terms be mandatory, with specific limits on amounts which can be invested in employer and member offered securities.**

APPENDIX 5 - DRAFT RETIREMENT FUNDS ACT AND EXPLANATORY NOTE

A5.1 Explanatory Note for Draft Retirement Funds Act

A5.1.1 The Proposed New Retirement Funds Act: Overview

The new Act will govern all Retirement Funds. Every Retirement Fund will have a trust deed, the structure of which is set out in the First Schedule of the Act. The parties to each Retirement Fund will be permitted to decide on the type of the scheme (pension or lump sum, defined benefit or defined contribution), the contribution requirement for the Retirement Fund and the type of benefits for the Retirement Fund. All other provisions of the trust deed of a Retirement Fund shall be those in the Second Schedule which provisions shall be incorporated into the trust deed by the mandatory incorporation provision contained in that trust deed (see clause 2 of the trust deed in the First Schedule of the Act).

The reason for putting a statutory standard trust deed into the Act is to remove one step from the current process of establishing a trust deed - the step of turning the requirements of the regulations (currently in Superannuation Schemes Regulations 1983) into clauses of the trust deed. At present the Government Actuary must consider all clauses in a trust deed to confirm that they comply with the regulations. That is time consuming for the Government Actuary and creates delays in the approving of trust deeds by the Government Actuary. There are precedents for standard documentation contained in an Act e.g. in the Second and Third Schedules to the Companies Act, which schedules set out the form and terms of Memorandum of Association and Articles of Association for companies (although the standard form Memorandum and Articles are not mandatory under that Act).

A party who wishes to alter one of the mandatory terms of the trust deed must make the amendment to the trust deed, then, having executed the trust deed, submit the trust deed to the Government Actuary for approval, explaining the reasons for deviating from the standard terms of the Second Schedule. The Government Actuary will only permit a deviation from the standard terms if it can be demonstrated that the deviation is necessary to comply with the scheme of benefits and contributions agreed to between the parties, or if the administrative record keeping referred to in Clause 4.1 of the Second Schedule is to be dealt with in another acceptable way.

A5.1.2 Proposed New Act

The Act (leaving aside for the moment the Schedules to the Act) deals with:

(a) The interpretation provision (section 2)

Essentially repeats section 2 of the 1976 Act and Regulation 2 of the 1983 Regulations. Definition of "solicitor" has been added - the solicitor is required to provide a certificate as to the contents of the trust deed when submitted for registration and classification.

There is a new concept of Specified Cash Benefit which fixes the maximum amount of the members lump sum entitlement under existing employee pension superannuation schemes approved under the Superannuation Schemes Act 1976. The concept is defined in section 2 of the proposed Act and the Trustees obligations to make the calculations are set out in section 9. Any tax for lump sums under modified E/T/T can be determined from that information.

(b) <u>The Constitution and registration and classification of Retirement Funds (sections 3 and 4)</u>

Section 12 of the 1976 Act provides for a person to seek approval and classification of the Government Actuary for any superannuation scheme. Section 4 of the Proposed Act provides that the trustees of a Retirement Fund may seek registration and classification of the Retirement Fund by the Government Actuary.

(c) <u>Information to be supplied to the Government Actuary when seeking registration and classification of the Retirement Fund (sections 5 and 6)</u>

Section 13 of the 1976 Act and the 1983 Regulations set out the requirements for approval by the Government Actuary. That section has been included in Section 6 of the proposed Act but has been expanded to cover the fact that the trust deed of a Retirement Fund must be in the form attached to the proposed Act, or the Government Actuary must be prepared to allow a deviation from that standard form.

There are two classifications under the Proposed Act - Retirement Income Fund and Retirement Lump Sum Fund.

A solicitors certificate must now be provided stating that the trust deed conforms with the requirements of the Act.

(d) <u>The rights of members of the Retirement Fund to receive information (section 7)</u>

The 1983 Regulations provided limited rights of members to receive information regarding a superannuation scheme and its financial position. Section 7 of the proposed Act considerably extends members rights to receive information regarding a Retirement Fund.

(e) <u>Contents of trust deed (section 8)</u>

This section in the proposed Act is new. As the 1976 Act and 1983 Regulations did not provide a standard form of trust deed a provision equivalent to this was not required. The 1976 Act and 1983 Regulations set out

matters that were to be incorporated into clauses of the trust deeds of superannuation schemes.

(f) Transitional arrangements for existing schemes (section 9)

This section is new in the proposed Act. Section 14 of the 1976 Act dealt with transitional arrangements at the time the 1976 Act came into force.

All existing schemes that have the approval of the Government Actuary under the 1976 Act are granted interim registration and classification by this provision to 1 April 1990. There is a limited power on the Government Actuary to extend the interim registration and classification.

(g) The power of the Government Actuary to put a Retirement Fund into receivership and to terminate the Retirement Fund (Section 10)

This provision is new for the proposed Act. Under the 1976 Act the Government Actuary has power to suspend a scheme or withdraw approval of the scheme or withdraw the classification of the scheme where the scheme did not comply with the 1976 Act or 1983 Regulations. The Government Actuary's powers under those provisions were not as precise as might have been the case - there was a difficulty of interpretation relating to the suspension powers in particular.

The power in the proposed Act enables the Government Actuary to put a Statutory Receiver into the Retirement Fund to replace the trustees, and subject to receiving a report from the Statutory Receiver, to require the Retirement Fund to be wound up.

(h) Decisions, objections and appeals against decisions of the Government Actuary (section 11)

The right of objection against a decision of the Government Actuary was contained in sections 16 and 19(2) - (11) of the 1976 Act and Regulations 41, 42 and 43 of the 1983 Regulations. The objection procedure (essentially the Government Actuary to review his decision followed by an appeal to the High Court Administrative Division) has been retained in the proposed Act. However the objection procedure is now fully set out in the proposed section 11.

(i) An offences provision (section 12)

This provision replaces section 17 of the 1976 Act, and makes it an offence to fail to comply with any provision of the proposed Act. However, section 12 excludes the

offence of failing to comply with conditions granted on approval of a scheme. The Government Actuary doesn't and hasn't given conditional approvals, so such an offence provision is unnecessary.

(j) A power to make regulations provision (section 13)

The regulation making power contained in section 18 of the 1976 Act has been considerably shortened to reflect the intention of setting out the regulatory regime for Retirement Funds in the Act rather than regulations made pursuant to the Act. The intention is that people should be able to find the detail of the regulatory regime in the Act rather than having to go from Act to regulations.

There is a general regulation making power provided to permit regulations that are necessary to give effect to the Act.

(k) Fees provisions (sections 14 and 15)

These provisions essentially repeat section 18A of the 1976 Act and Regulation 47A of the 1983 Regulations.

(l) The mechanisms to enable variations of trust deeds (section 16)

The power to vary trust deeds is set out in section 19 of the 1976 Act and Regulation 6 of the 1983 Regulations. The provision has been modified, and a trust deed may be modified to make amendments so that the Retirement Fund complies with the provisions of the proposed Act by 1 April 1990.

All amendments to a trust deed must be acceptable to the Government Actuary if they are to be effective.

Section 16(3) of the proposed Act automatically deems a new investment powers provision into every trust deed that has interim registration and classification under the proposed Act (that is to all schemes currently registered under the 1976 Act).

(m) Secrecy (section 17)

Section 20 of the present Act (as amended by the Official Information Act) has been essentially repeated in the proposed Act.

(n) Personal liability (section 18)

Section 21 of the 1976 Act has been essentially repeated in the proposed Act. However no actuary or solicitor advising the trustees, or trustee, will be liable for acts done in good faith.

(o) <u>Exemption from the Perpetuities Act (section 19)</u>

This provision is new in the proposed Act. The exemption from the rule against perpetuities for superannuation schemes under the 1976 Act is currently contained in the Perpetuities Act 1964.

(p) <u>Reports on and certificates for Retirement Funds (section 20)</u>

Section 20 of the proposed Act brings the reporting to the Government Actuary requirement into the Act. The annual reports provision is currently contained in Regulation 8 of the 1983 Regulations. Section 20 of the proposed Act operates in conjunction with clause 10 in the Second Schedule to the proposed Act which is a mandatory trust deed provision for all Retirement Funds.

(q) <u>Repeal of sections 2A, 2B and 2C and Part II and Part III of the Superannuation Schemes Act 1976 as from 1 April 1989 (section 21)</u>

This section is new. Part I of the Superannuation Schemes Act 1976 is retained as it may be necessary to keep those dissolution provisions in force. The repeal of the other provisions of that Act will take effect from 1 April 1989 to permit the Government Actuary to process the approval of recently commenced schemes where approval of such schemes was not sought prior to their commencement.

A5.1.3 First Schedule

The First Schedule and its contents are new - they do not correspond to a similar Schedule or provisions in the 1976 Act. They are necessary in the process of creating the standard form of trust deed (and removing the need to turn regulations into clauses of the trust deed). The First Schedule sets out the form of the trust deed and deals with:

(a) the establishment of the Retirement Fund (clause 1);

(b) interpretation, terms and conditions - the terms and conditions set out in the Second Schedule are incorporated into the deed by this clause. Also any definitions that are required for the operation of the membership, contributions, benefits and number, appointment and retirement of trustees provisions can be supplied by the parties for each individual trust deed (clause 2);

(c) membership of Retirement Fund provision (clause 3);

(d) contributions to be made to Retirement Fund by members and employers if applicable (clause 4);

(e) benefits payable to members (clause 5);

- retirement benefits (clause 5.1);
- benefit on death (clause 5.2);
- benefit on permanent incapacity in service (clause 5.3);
- benefit on leaving service (clause 5.4);

(f) number, appointment and retirement of trustees (clause 6).

Under the 1976 Act there is no minimum number of trustees. Under the proposed Act at least one trustee of the Retirement Fund must be a member of the Retirement Fund - see section 3(2).

A5.1.4 Second Schedule

The Second Schedule deals with the following matters:

(a) Interpretations (clause 1);

A standard definitions section is set out to govern the standard trust deed clauses - the definitions parallel the definitions in the Act.

(b) Investments (clause 2);

Regulation 10 of the 1983 Regulations currently sets out the investment powers of the trustees of a superannuation scheme. The new investment powers contained in clause 2 of the Second Schedule provide for a wider range of investments - however it depends upon the powers set out in the Trustee Act, and that Act is currently being amended.

The investment powers relating to investments made with members or their employers under a Retirement Fund have been curtailed. In particular the total market value of such investments cannot exceed 10% of the market value of the investments of the Retirement Fund.

Clause 2.4 permits investments made in accordance with the 1983 Regulations that no longer qualify under the proposed Act to be retained until 27 August 1996 or their earlier maturity.

(c) Powers of trustees (clause 3);

The powers of trustees as set out in the Second Schedule do not derive from the 1976 Act or the 1983 Regulations - the powers are necessary for a trust deed and are the normal sorts of powers contained in a deed.

(d) Accounts - actuarial examination (clause 4) ;

The requirement for the accounts of a Retirement Fund that does not operate on the principle of unallocated funding are more fully set out in clause 4 than in Regulation 8 of the 1983 Regulations.

If the Retirement Fund operates on the principle of unallocated funding or provides benefits in the form of pensions made under the Retirement Fund an actuarial report on the Retirement Fund is required at least once every three years, and a copy of the report is to be provided to the Government Actuary. A simplified copy of the report is to go to each member of the Retirement Fund. The clause is an extension of Regulation 7 of the 1983 Regulations.

(e) Advice to members of details of Retirement Fund (clause 5);

This clause considerably extends the entitlement of each member of the Retirement Fund to receive detailed financial information regarding the Retirement Fund. The current information requirement is in Regulation 9 of the 1983 Regulations.

(f) No alienation of members rights permitted (clause 6);

This clause derives from Regulation 14 of the 1983 Regulations.

(g) Bankruptcy of member (clause 7);

(h) Incapacity of member (clause 8);

(i) Amendment to trust deed (clause 9);

The existing amendment power is contained in Section 19 of the 1976 Act and Regulation 6 of the 1983 Regulations. Clause 9 of the Second Schedule now provides the amendment power for each Retirement Fund. A trust deed may not be amended without the written consent of every member whose interest in the Retirement Fund at the date of the amendment could be reduced or adversely affected by the amendment. No amendment shall have effect unless the Act has been complied with and the Government Actuary has approved the amendment.

(j) Annual reports (clause 10);

This clause derives from Regulation 8 of the 1983 Regulations. However the annual reporting requirements have been increased.

(k) Termination (clause 11);

Termination is currently dealt with in Regulation 28 of the 1983 Regulations. The termination provision in clause 11 of the Second Schedule will prevent any assets of the Retirement Fund reverting to any employer without the prior written consent of the Government Actuary.

On termination the amount of the Retirement Fund in respect of each member may be transferred for the members benefit to another Retirement Fund - clause 11.2.

(l) Benefit payments (clause 12);

The benefits payments provision is new. It restricts the payment of benefits to the following situations:

the retirement of the member;

the death of a member;

the permanent incapacity of the member;

the member leaves the service of the member's employer (if applicable);

the transfer by the member of the amount held for the member's benefit to another registered Retirement Fund.

(m) Reserve fund (clause 13);

Regulations 26 and 27 of the 1983 Regulations cover the Reserve Fund and its use. Those regulations are effectively summarised in clause 13 of the Second Schedule of the proposed Act.

(n) Notification to Government Actuary of address and changes of address (clause 14);

This clause effectively repeats Regulation 44 of the 1983 Regulations.

(o) Receivership of Retirement Fund (clause 15);

This clause is new. It reflects the type of receivership clause contained in a debenture trust deed, and its purpose is to provide the framework for a statutory receiver to manage a Retirement Fund and if necessary to wind it up. The clause operates in conjunction with section 10 of the proposed Act.

A5.1.5 Third Schedule

The Third Schedule is the fee schedule for publication by the

Government Actuary in the Gazette setting out the fees payable to the Government Actuary with regard to the registration and classification of a Retirement Fund and any other matters relating to the Retirement Fund.

A5.1.6 Dissolution of the New Zealand Superannuation Corporation

We have left the sections relating to the dissolution of the New Zealand Superannuation Corporation and Scheme as Part I of the 1976 Act - at this stage we have not considered whether it is still necessary for these provisions to remain in operation. It is possible that the transition that they were required to achieve has now been completed. That matter has yet to be considered.

A5.1.7 Provisions that have been removed from the current Superannuation Schemes Act 1976 and the Superannuation Schemes Regulations 1983 which have not been included in the proposed Act

Sections 2A and 2B dealing with class A funds in relation to employee lump sum schemes and class A funds in relation to personal lump sum schemes have been deleted as they are unnecessary.

A5.1.8 General

The long title to the Superannuation Schemes Act 1976 states that it is an Act to provide for the dissolution of the New Zealand Superannuation Corporation and the New Zealand Superannuation Scheme, and also to provide for the approval of other superannuation schemes. Part I of that Act deals with the dissolution, Part II sets out the regime for the approval of superannuation schemes by the Government Actuary, and Part III sets out certain miscellaneous provisions relating to superannuation schemes. There appears to be two main reasons for the regulation of superannuation schemes under the Act:

(a) The protection of the interests of members of a superannuation scheme by an independent third person namely the Government Actuary;

(b) Income Tax advantages conferred by the legislature on superannuation schemes that were subject to the regulation of the Government Actuary.

Under T/T/E no tax advantage is conferred. Accordingly, the only justification for maintaining a regulatory regime with regard to such a Retirement Fund is the concept of the protection of members of the Retirement Fund - protection of their accumulating amount and the maintenance of their pension after retirement.

Where the contributions by an employer and by a member of a Retirement Fund would be deductible, a non-standard tax

treatment is provided to savings made in a superannuation context to provide for income of members after retirement. Accordingly, in addition to the "prudential supervision" requirement, there is a public interest in the regulation of such Retirement Funds and there is a need for regulatory control.

We have rewritten the Superannuation Schemes Act 1976 and 1983 Regulations to fit into a regime under which there is no difference as between an employer subsidised Retirement Fund and a personal Retirement Fund. Also references to class A and class B funds have been deleted as such funds will be treated on exactly the same basis from a taxation point of view.

A5.2 Draft Retirement Funds Act

Index to the Retirement Funds Act

1. Short title and commencement
2. Interpretation
3. Constitution of Retirement Funds
4. Registration and Classification of Retirement Funds
5. Information to be Supplied when seeking Registration and Classification
6. Requirements for Registration and Classification
7. Members Rights to Information
8. Contents of Trust Deed
9. Transitional arrangements for existing Superannuation Schemes
10. Receivership and Termination of a Retirement Fund
11. Decisions, Objections and appeals against decisions
12. Offences
13. Regulations
14. Fees
15. Government Actuary may decline to act where appropriate fee not paid
16. Power to Vary Trust Deeds in existence at the commencement of this Act
17. Secrecy
18. Personal Liability
19. Amendment to Perpetuities Act
20. Reports on and Certificates for Retirement Funds
21. Repeal of Parts of Superannuation Schemes Act 1976 [Query whether it is necessary to retain the sections from the Superannuation Schemes Act 1976 relating to Dissolution of NZ Superannuation Scheme and Corporation]

FIRST SCHEDULE - FORM OF TRUST DEED

SECOND SCHEDULE - MANDATORY TERMS OF TRUST DEED

THIRD SCHEDULE - FEES SCHEDULE FOR PUBLICATION BY GOVERNMENT ACTUARY IN GAZETTE

THE RETIREMENT FUNDS ACT 1988

1. SHORT TITLE AND COMMENCEMENT

2. INTERPRETATION

(1) In this Act, unless the context otherwise requires, -

"Accrued Benefits" as at a specified date means the benefits attributable to membership of the Retirement Fund prior to that date whether or not the trust deed gives a member an absolute right to any such benefit at that date. Accrued benefits are based on a member's past compensation levels as defined in the trust deed unless the trust deed defines a benefit by reference to a members future compensation in which case accrued benefits is to include assumptions about the members future compensation in the calculation of that benefit:

"Actuary" means a person who:

(a) Is a Fellow of the New Zealand Society of Actuaries and has been a Fellow of the New Zealand Society of Actuaries for a period of at least one year; or

(b) Has other qualifications and work experience as an actuary, and has been approved by the Minister as an actuary for the purposes of these regulations:

"Auditor" means a person who is the holder of a certificate of public practice issued by the New Zealand Society of Accountants:

"Benefit" means any annuity, allowance, refund, or other benefit payable under a Retirement Fund:

"Commissioner" means the Commissioner of Inland Revenue appointed under the State Services Act 1962; and includes any person for the time being authorised (whether by delegation by him or otherwise) to exercise or perform any of his powers or functions:

"Employee" means any person who is engaged to work or works under a contract of service or apprenticeship with an employer, whether by way of manual labour, clerical or professional work, or otherwise:

"Employer" means any person who pays or is liable to pay to any person (being an employee within the meaning of this subsection) any earnings as an employee:

"Government Actuary" includes any person for the time being authorised (whether by delegation by him or otherwise) to exercise or perform any of the powers or functions of the Government Actuary :

"Member" means a person who has been admitted to membership of the Retirement Fund and who is or may become entitled to benefits under the Retirement Fund.

"Minister" means the Minister of Finance:

"Person", in relation to an employer, includes a company or other body corporate, whether incorporated in New Zealand or elsewhere, and a public body; and also includes an unincorporated body of persons, a partnership, an association of persons carrying on a joint undertaking, and a Government Department:

"Permanent Incapacity" means permanent physical or mental incapacity suffered by any person that is of such an extent that, having regard to the previous employment and other characteristics of that person, that person is unlikely to have a significant earning capacity in the future.

"Retirement Fund" means any New Zealand resident trust established by its trust deed principally for the purpose of providing retirement benefits to beneficiaries who are natural persons:

"Retirement Income Fund" means a Retirement Fund governed by conditions that require every benefit in excess of the Specified Cash Benefit of every member of the Retirement Fund to be taken in the form of an income dependant on the life of the member and (if so stated in the trust deed) after the death of the member, on the life of a surviving spouse or a dependant of the member, and that do not enable any member to commute to, or to capitalise the benefits into, a lump sum which exceeds any amount, the payment of which would reduce the income otherwise payable by 25 per cent.

"Retirement Lump Sum Fund" means any Retirement Fund that is not a Retirement Income Fund.

"Solicitor" means a Practitioner as defined in the Law Practitioners Act 1982 holding a current Practising Certificate and who is a principal of a firm of legal practitioners or a sole practitioner:

"Specified Cash Benefit" means (with regard to each member of a scheme which at 30 June 1988 is classified by the Government Actuary under the Superannuation Schemes Act 1976 as either:

(a) a subsidised employee pension superannuation scheme; or

(b) an unsubsidised employee pension superannuation scheme;

and which has always been part of a Retirement Fund classified as a Retirement Income Fund by the Government Actuary under this Act from which no benefit has been paid to that member other than by way of transfer to another registered Retirement Income Fund) the greater of:

(i) the maximum amount which the member could have received as a lump sum if the Retirement Fund were to be wound up on 30 June 1988; and

(ii) the maximum amount which the member could have received if the member had left the Retirement Fund by reason of withdrawal or retirement as at 30 June 1988; and

in respect of which sufficient information has been provided to the Government Actuary before 31 March 1989, and which the Government Actuary has approved.

A members Specified Cash Benefit cannot be apportioned between two or more registered Retirement Income Funds and will be deemed to be reduced to zero for taxation purposes immediately after any payment other than by way of transfer to another Retirement Income Fund is made to or in respect of that member under the Retirement Income Fund.

[Relevant only for modified E/T/T]

"Trustees", in relation to any Retirement Fund, means the persons who are designated as such in the trust deed or other instrument governing the Retirement Fund, and who have the responsibility for the administration and investment of the Retirement Fund:

"Trust Deed" or "Deed" means a trust deed of a Retirement Fund in the form set out in the First Schedule as completed with regard to the matters outlined in that schedule or any trust deed where the Government Actuary has in the sole discretion of the Government Actuary specifically permitted a departure from the form of Trust Deed set out in the First Schedule :

"Vested Benefit" means that part of Accrued Benefits to which a member has an absolute right.

(2) For the purposes of this Act and any regulations made under this Act a Retirement Fund shall be deemed to operate on the principle of unallocated funding if the contributions to the Retirement Fund are not allocated on a defined basis to individual members.

PART I

REGISTRATION OF RETIREMENT FUND

3. CONSTITUTION OF RETIREMENT FUNDS

(1) Every Retirement Fund that is not constituted under an Act of Parliament of New Zealand shall be governed by a Trust Deed that shall be interpreted and administered in accordance with New Zealand law.

(2) At least one member of a Retirement Fund shall be a trustee of that Retirement Fund; and that office shall not affect the member's entitlements under that Retirement Fund.

4. REGISTRATION AND CLASSIFICATION OF RETIREMENT FUNDS

At any time after the commencement of this Part of this Act, the trustees of any Retirement Fund may seek registration and classification of the Retirement Fund by the Government Actuary.

5. INFORMATION TO BE SUPPLIED WHEN SEEKING REGISTRATION AND CLASSIFICATION

To apply for registration or classification of a Retirement Fund the trustees of the Retirement Fund shall supply to the Government Actuary 2 copies of the executed trust deed or other instrument governing the Retirement Fund, together with the following information -

(a) The commencement date of the Retirement Fund.

(b) The classification sought for the Retirement Fund.

(c) The names of every employer (if applicable) and trustee; and every administration manager, investment manager, insurer, actuary, auditor and solicitor (as applicable) acting for or advising the Trustees.

(d) A copy of the most recent accounts of the Retirement Fund.

(e) The name and address of the person to whom all correspondence should be sent.

(f) The date upon which the financial year of the Retirement Fund ends.

(g) In the case of a Retirement Fund operating on the principle of unallocated funding -

(i) the certificate of an actuary stating the rates or amounts of contributions which in that actuary's opinion are sufficient to fund the

benefits for members and other beneficiaries of the Retirement Fund, and specifying the actuarial funding method used in coming to that opinion; and

(ii) a statement of the rates or amounts of contributions which are to be paid.

(h) A certificate from a Solicitor that the trust deed is in accordance with this Act and any regulations made under this Act.

(i) A copy of the explanatory material that has been or is intended to be issued to members or potential members.

6. REQUIREMENTS FOR REGISTRATION AND CLASSIFICATION

(1) The Government Actuary shall register the Retirement Fund if -

(a) the Trust Deed is in the form and contains only the conditions set out in the First Schedule, or the Government Actuary has permitted a specific departure from such form or conditions, or both;

(b) the Government Actuary is satisfied that, having regard to all the circumstances, the interests of the persons who may be expected to become entitled to benefits under the Trust Deed are properly provided for in the matters of contributions, benefits and the vesting of accrued benefits, which matters are to be contained in the Trust Deed.

(c) the Trust Deed meets all other requirements for registration prescribed by this Act and any regulations made under this Act; and

(d) the Government Actuary is satisfied that, having regard to all the circumstances, the financial basis of the operation of the Retirement Fund is satisfactory and that the security of benefits is satisfactory.

(2) Where any scheme has been registered under subsection (1) of this section, the Government Actuary shall classify the scheme as either:

(a) a Retirement Income Fund; or

(b) a Retirement Lump Sum Fund.

(3) Where an application is made to have a Retirement Fund registered classified or re-classified under this section, and the Retirement Fund is so registered classified or re-classified, the registration classification or re-classification shall be deemed to

take effect on the date the application for such registration classification or re-classification is received by the Government Actuary or such later date as may be determined by agreement between the applicant and the Government Actuary, whether or not changes to the Retirement Fund were necessary to enable the Retirement Fund to be registered, classified or re-classified.

(4) The Trustees shall provide a copy of the register of members Specified Cash Benefits (prepared in accordance with section 9(6) of this Act) to the Government Actuary at the time of applying for registration of a Retirement Fund under this Act.

7. MEMBERS RIGHTS TO INFORMATION

(1) A member shall have the right:

(a) to peruse a copy of the Trust Deed at any reasonable time and to obtain a copy for a reasonable fee;

(b) to receive a statement of the amount of the member's own accrued benefits as at the close of the preceding financial year;

(c) to receive a statement of the member's own withdrawal benefit as at the close of the preceding financial year.

(2) A member shall be given each year a copy of the most recent trustees annual report containing the information specified under Clause 10 of the Second Schedule to this Act.

(3) A member shall, before his entry to the Retirement Fund, be advised in writing of -

(a) brief details of the Retirement Fund;

(b) the member's principal rights and benefits;

(c) any charges or fees that may be imposed;

(d) the rates or amounts of contributions payable and any maximum or minimum rates or amounts which are applicable;

(e) the right to receive the information referred to in subsection (1) of this section.

(4) A member shall before his entry to the Retirement Fund be given a copy of the most recent trustees annual report containing the information specified under Clause 10 of the Second Schedule to this Act; or, if there is no such report, then the information stated in Clause 10(1)(g) and (h) of the Second Schedule to this Act.

8. CONTENTS OF TRUST DEED

(1) Every registered Retirement Fund shall have a Trust Deed which Trust Deed shall be in the form set out in the First Schedule and contain the clauses set out in the Second Schedule (except insofar as the Government Actuary in the sole discretion of the Government Actuary approves a departure from the clauses contained in the Second Schedule) and shall contain the following:

(a) The conditions of membership entry to the Retirement Fund and the conditions as to termination of membership of the Retirement Fund;

(b) (i) The rates or amounts of contributions of employers (if applicable) and members.

(ii) The basis on which contributions are to be made to the Retirement Fund.

(c) The conditions under which benefits become payable and the basis of calculation of each such benefit. If membership of a Retirement Fund is a condition of a member's employment by an employer, then such member is to have an absolute right to receive benefits provided by contributions paid into that Retirement Fund by that employer on that members behalf.

(d) The number of and provision for the appointment and retirement of Trustees;

but subject always to the limitation that the matters referred to in (a), (b), (c) and (d) above shall not be inconsistent with any of the provisions of the Second Schedule (or any departures therefrom that have been approved in writing by the Government Actuary) and if there is any inconsistency the provisions of the Second Schedule shall prevail.

(2) The terms and conditions set out in the Second Schedule to this Act shall be regarded as forming part of this Act.

9. TRANSITIONAL ARRANGEMENTS FOR EXISTING SUPERANNUATION SCHEMES

(1) Notwithstanding section 6 of this Act:

(a) Any Superannuation Scheme approved and classified by the Government Actuary under Part II of the Superannuation Schemes Act 1976 on the date this Act comes into force shall be deemed to have been granted interim registration and classification by the Government Actuary under this Act until the 1st day of April 1990 on the date this Act comes into force; and

(b) Any Superannuation Scheme approved and classifed by the Government Actuary under Part II of the Superannuation Schemes Act 1976 from the date this Act comes into force until the date of the repeal of Part II of the Superannuation Schemes Act 1976 shall be deemed to have been granted interim registration and classification by the Government Actuary under this Act as from the date of that approval.

(2) In any case where an existing superannuation scheme is deemed to have been granted interim registration and classification as aforesaid, application for the registration and classification of the existing superannuation scheme may be made under sections 4 and 6 of this Act at any time before the expiration of that interim registration and classification, and the Government Actuary may -

(a) grant an extension of the interim registration and classification, for such period as the Government Actuary considers necessary for the determination of the application; or

(b) grant registration and classification of the existing superannuation scheme in accordance with those sections.

(3) Any existing superannuation scheme which had been classified by the Government Actuary as either:

(a) a subsidised employee pension superannuation scheme; or

(b) an unsubsidised employee pension superannuation scheme; or

(c) a personal pension superannuation scheme

shall be granted interim classification as a Retirement Income Fund.

(4) Any scheme which had been classified by the Government Actuary as either:

(a) a subsidised employee lump sum superannuation scheme; or

(b) an unsubsidised employee lump sum superannuation scheme; or

(c) a personal lump sum superannuation scheme

shall be granted interim classification as a Retirement Lump Sum Fund.

(5) Any member of an existing superannuation scheme which was classified by the Government Actuary as a "personal pension superannuation scheme" or a "personal lump sum superannuation scheme" under the Superannuation Schemes Act 1976 at the date of the repeal of Part II of that Act may, with the consent of the trustees of that scheme, transfer the member's own benefits to any Retirement Fund which has been granted registration or interim registration by the Government Actuary under this Act.

(6) The Trustees of every superannuation scheme approved under the Superannuation Schemes Act 1976 shall calculate the Specified Cash Benefit in respect of each member of that scheme. The amount of the Specified Cash Benefit for each scheme member shall be recorded by the Trustees on a separate register. The register shall be kept by the Trustees for at least 10 years after the last member mentioned on the register has left the scheme.

(7) The Trustees of every superannuation scheme approved as an employee pension superannuation scheme under the Superannuation Schemes Act 1976 shall provide an interim report to the Government Actuary no later than 31 March 1989 setting out the Specified Cash Benefit for each member of the scheme.

10. RECEIVERSHIP AND TERMINATION OF A RETIREMENT FUND

(1) The Government Actuary may suspend the trustees of a Retirement Fund and may appoint a Statutory Receiver of a Retirement Fund if:

(a) the Government Actuary is not satisfied that the requirements for Retirement Funds then in force under this Act and any regulations made under this Act, have been complied with; or

(b) The Government Actuary is not satisfied with the financial basis of the operation of the Retirement Fund or with the security of the benefits or the adequacy of the management of the Retirement Fund; or

(c) the Retirement Fund has no members and no beneficiaries.

(2) The Statutory Receiver shall have:

(a) The rights and powers to manage and operate the Retirement Fund otherwise conferred by the Trust Deed upon the trustees and the other rights and powers referred to in this section; and

(b) The rights and powers conferred upon receivers by law except to the extent that those rights and powers conferred on a receiver by law are negatived by this Act; and

(c) The power to call a meeting of the members of the Retirement Fund.

(3) Upon receipt of a report from the Statutory Receiver, the Government Actuary may order a Retirement Fund to be wound up or may permit the Retirement Fund to remain in existence.

(4) When the Government Actuary orders a Retirement Fund to be wound up in accordance with subsection (3) above:

(a) the debts of the Retirement Fund to persons other than Members shall be satisfied out of the assets of the Retirement Fund; and

(b) the remaining assets of the Retirement Fund shall be distributed to each Member in proportion to each Member's Accrued Benefits as at the date of distribution; and

(c) the distribution shall be in accordance with Clause 11 of the Second Schedule to this Act.

(5) The Government Actuary may at any time reinstate the trustees of a Retirement Fund where those trustees have been suspended under sub-section (1) of this Section.

11. <u>DECISIONS, OBJECTIONS AND APPEALS AGAINST DECISIONS</u>

(1) <u>Notice of Decisions</u> - The Government Actuary shall, as soon as practicable after making a decision in respect of which an objection may be made under Section 11 of this Act, give notice of the decision in writing to the person who sought the decision, and to the trustees of the Retirement Fund.

(2) <u>Objections</u> - Any person who is dissatisfied with a decision made by the Government Actuary in the exercise of his powers, functions, and discretions under this Act may object to that decision to the Government Actuary in any case where the decision -

(a) Relates to the registration, classification, re-classification or receivership of that Retirement Fund; or

(b) Is an order of the Government Actuary to wind up that Retirement Fund.

(3) Any objection under this section shall be made and considered in accordance with this Act and any regulations made under this Act, and in the absence of any such procedure, or so far as any such procedure does not extend, in such manner as the Government Actuary may determine.

(4) Notice of Objections

(a) Every objection under section 11 of this Act to a decision of the Government Actuary shall be made by delivering or posting a written notice of objection to the Government Actuary.

(b) Every such notice of objection shall state briefly the grounds of the objection and shall give a current postal address to which correspondence in respect of the objection may be sent.

(c) Every such notice of objection shall be given within 28 days after the date on which notice of the decision is received or deemed to have been received, or within such extended time as the Government Actuary may allow on application made either before or after the expiration of the 28 day period.

(5) Consideration of Objections

(a) Every objection made under this Act and any regulations made under this Act to a decision of the Government Actuary shall be considered by the Government Actuary within 28 days after the receipt of the objection.

(b) The Government Actuary shall, as soon as practicable after making a decision in respect of an objection, give notice of the decision in writing to the person who made the objection, and to the trustees of the Retirement Fund.

(6) Any person whose objection is disallowed by the Government Actuary may appeal against that disallowance to the High Court.

(7) Every appeal under this section shall be heard and determined by the Administration Division of the High Court.

(8) Every such appeal shall be by notice of appeal in writing and shall be lodged with the Registrar of the High Court, together with a duplicate of that notice, within 28 days after the date on which the appellant was notified of the disallowance of the objection or within such further time as the High Court may allow on application made either before or after the expiration of those 28 days.

(9) In its determination of any appeal, the High Court may confirm, modify, or reverse the order or decision appealed against.

(10) Subject to the provisions of this section, the procedure in respect of any such appeal shall be in accordance with the rules of the High Court.

12. OFFENCES

(1) Every person commits an offence against this Act who -

(a) Refuses or fails to deliver any statement or report or copy or certificate or to furnish any return or to give any certificate as and when required in accordance with the form of Trust Deed in the First Schedule and any requirements of this Act; or

(b) Offends against provisions of this Act or the provisions of any trust deed issued in terms of this Act.

(2) Every person who commits an offence against this Act or any regulations made under this Act for which no penalty is provided in this Act, or in any regulations made under this Act, is liable on summary conviction to a fine not exceeding $500.

(3) Where a company commits an offence against this Act, every officer of the company who knowingly and wilfully authorises or permits the offence also commits an offence against this Act.

13. REGULATIONS

The Governor-General may from time to time, by Order in Council, make regulations for all or any of the following purposes -

(a) Prescribing the fees payable or the rate at which fees are to be calculated for applications for registration classification or re-classification of Retirement Funds, amendments to registered Retirement Funds, and for the making of statements, returns, certificates, reports, applications, and the giving of notices, required under this Act, or any regulations made under this Act:

(b) Providing for such matters as are contemplated by or necessary for giving full effect to the provisions of this Act and the full administration thereof.

14. FEES

The fees payable for every application made to the Government Actuary with regard to the registration classification or re-classification of a Retirement Fund shall be determined by the Government Actuary from time to time and published in the Gazette in the form set out in the Third Schedule (which form may be modified by the Government Actuary in the Government Actuary's sole discretion from time to time).

15. GOVERNMENT ACTUARY MAY DECLINE TO ACT WHERE APPROPRIATE FEE NOT PAID

(1) Where any fee is payable under this Act or any regulations made under this Act the Government Actuary may, in addition to the exercise of any other powers to recover that fee, decline to take any action in respect of the matter for which the fee is payable or decline to accept the statement, return, certificate, report, application, notice, or document to which the fee relates unless the fee has been paid or the Government Actuary is satisfied that adequate arrangements have been made for the later payment of that fee.

(2) Where any fee is calculated on a hourly basis under this Act or any regulations made under this Act, the Government Actuary may decline to take action in respect of the matter unless the Government Actuary's estimate of the likely fee has been paid, or the Government Actuary is satisfied that adequate arrangements have been made for the later payment of that fee.

16. POWER TO VARY TRUST DEEDS IN EXISTENCE AT THE COMMENCEMENT OF THIS ACT

(1) In order to make any Retirement Fund that has interim registration pursuant to this Act eligible for registration and classification by the Government Actuary prior to the 1st day of April 1990, the trustees of the Retirement Fund may make such amendments to that instrument or those conditions as are necessary notwithstanding any Act or rule of law or the provisions of the instrument or conditions governing any Retirement Fund.

(2) If the Government Actuary considers that the amendments proposed by the trustees under subsection (1) of this section are not equitable to members and other beneficiaries of the Retirement Fund, then the Government Actuary shall refuse to agree to the proposed amendments.

(3) Every trust deed of every Retirement Fund which has been deemed to have been granted interim registration and classification by the Government Actuary under this Act shall be deemed to have its existing conditions relating to the investment powers of the trustees cancelled and replaced by the following -

(a) subject to subclauses (b), (c), (d) and (e) of this clause, all money which is available for investment shall be invested in any manner that would be authorised by the Trustee Act 19??;

(b) No investment of the Retirement Fund can be made in any securities or investments issued or granted by -

(i) any member or any employer of any member, or

(ii) any person who is a relative of or person associated with any such member or employer,

if the then total market value of such investments would exceed 10 per cent of the market value of all the investments of the Retirement Fund;

(c) No funds of the Retirement Fund can be used directly or indirectly in any business in any manner other than by an investment authorised by or under this clause;

(d) Where any investment that has been made before the Retirement Funds Act 1988 came into effect, and was in accordance with the Superannuation Schemes Regulations 1983, that investment may be retained until -

(i) its maturity, contractual repayment, sale, or other disposal; or

(ii) the 27th day of August 1996 -

whichever is the earlier, without any effect on the registration of the Retirement Fund;

(e) For the purposes of this clause, the expressions "business", "relative", and "associated person" shall have the same meanings as in the Income Tax Act 1976.

17. SECRECY

No person, being -

(a) The Government Actuary or a former Government Actuary; or

(b) An officer or employee in the service of the Government Actuary; or

(c) A person who was formerly in the service of the Government Actuary, -

shall be required to produce in any Court or tribunal any book or document or to divulge or communicate to any Court or tribunal any matter or thing coming under that person's notice in the performance of that person's duties, except when it is necessary to do so for the purpose of carrying into effect any provision of this Act.

18. PERSONAL LIABILITY

(1) Neither the Government Actuary nor the Commissioner nor any person in the service of the Government Actuary or the Commissioner shall be personally liable for any act done or omitted by the Government Actuary or the Commissioner or any such person in good faith in pursuance or intended pursuance of the functions or powers of the Government Actuary or the Commissioner under this Act.

(2) No Actuary or Solicitor acting for or advising the Trustees, or Trustee, shall be personally liable for any act done or omitted to be done in good faith in pursuance or intended pursuance of any amendment to a Retirement Fund arising from Section 16(1) of this Act.

19. AMENDMENT TO PERPETUITIES ACT

(1) Any rule against perpetuities shall not apply to Retirement Funds which have been registered by the Government Actuary under this Act and any regulations made under this Act, including Retirement Funds with interim registration under this Act.

20. REPORTS ON AND CERTIFICATES FOR RETIREMENT FUNDS

(1) The trustees of every Retirement Fund that has been granted or is deemed to have been granted registration or interim registration by the Government Actuary under this Part of this Act shall provide to the Government Actuary:

(a) The Trustees annual report containing the information specified under clause 10 of the second Schedule to this Act within 3 months after the end of each financial year of the Retirement Fund; and

(b) The report of the Actuary required by clause 4.2 of the second schedule to this Act within 3 months of the date at which the financial position of the Retirement Fund was examined.

(2) The Government Actuary may require the trustees of every registered Retirement Fund to furnish the Government Actuary with such further information in respect of the Retirement Fund as he may require.

21. REPEAL OF PARTS OF SUPERANNUATION SCHEMES ACT 1976

(1) Sections 2A, 2B and 2C and Part II and Part III of the Superannuation Schemes Act 1976 are repealed as from 1 April 1989.

(2) All Regulations made under the Superannuation Schemes Act 1976 are repealed as from 1 April 1989.

FIRST SCHEDULE

THIS DEED made the day of 19

BY [ ]

RECITALS

A. [ ] desires to establish a retirement fund for the benefit of the members from time to time of that fund, which fund is established pursuant to the Retirement Funds Act 1988.

B. [ ] shall be the Trustees of that retirement fund.

C. The terms and conditions of the retirement benefits are set out below (except to the extent that they are in conflict with or would modify to any extent the terms and conditions set out in the Second Schedule to the Retirement Funds Act 1988) together with the terms and conditions set out in the Second Schedule of the Retirement Funds Act 1988.

NOW THIS DEED WITNESSES AND IT IS HEREBY AGREED AND DECLARED as follows:

1.0 ESTABLISHMENT OF RETIREMENT FUND

1.1 A retirement fund to be known as the [ ] RETIREMENT FUND is hereby established with effect from [ ] and shall be managed and administered in accordance with the provisions of this Trust Deed.

1.2 The annual balance date of the Fund shall be [ ]

2.0 INTERPRETATION, TERMS AND CONDITIONS

2.1 Apart from the matters referred to in clauses 3, 4, 5 and 6 below (relating to eligibility for membership, contributions, benefits and trustees) the definitions, terms and conditions of this Deed of Trust are set out in the Second Schedule to the Retirement Funds Act 1988, except as stated in clause 2.2 below.

2.2 In this Deed :

[include definitions as are required for the operation of clauses 3, 4, 5 and 6 below].

3.0 MEMBERSHIP

4.0 CONTRIBUTIONS

5.0 BENEFITS

5.1 Retirement Benefits

5.2 Benefit on Death

5.3 Benefit on Permanent Incapacity In Service

5.4 Benefit on Leaving Service

6.0 NUMBER APPOINTMENT AND RETIREMENT OF TRUSTEES

DATED the day of 19

Executed by:

INDEX TO SECOND SCHEDULE

1. Interpretation
2. Investment Powers
3. Powers of the Trustees
4. Accounts - Actuarial Examination
5. Advice to Members of Details of Retirement Fund
6. No Alienation of Members Rights Permitted
7. Bankruptcy of Member
8. Incapacity of Member
9. Amendment to Trust Deed
10. Annual Reports
11. Termination
12. Benefit Payments
13. Reserve Fund
14. Notification to Government Actuary of Address and Changes of address
15. Receivership of Retirement Fund

SECOND SCHEDULE

(The following terms and conditions shall be contained in every retirement fund registered pursuant to this Act unless a specific alteration to such terms and conditions has been agreed to by the Government Actuary and notified in writing to the person seeking the registration of the retirement fund.)

1. INTERPRETATION

1.1 In this Deed unless the contrary intention appears:

"Accrued Benefits" as at a specified date means the benefits attributable to membership of the Retirement Fund prior to that date whether or not the trust deed gives a member an absolute right to any such benefit at that date. Accrued benefits are based on a members past compensation levels as defined in the trust deed unless the trust deed defines a benefit by reference to members future compensation in which case accrued benefits is to include assumptions about the members future compensation in the calculation of that benefit;

"Act" means the Retirement Funds Act 1988;

"Actuary" means a person who:

(a) Is a Fellow of the New Zealand Society of Actuaries and has been a Fellow of the New Zealand Society of Actuaries for a period of at least one year; or

(b) Has other qualifications and work experience as an actuary, and has been approved by the Minister as an actuary for the purposes of the Act;

"Auditor" means a person who is the holder of a certificate of public practice issued by the New Zealand Society of Accountants;

"Benefit" means any annuity, allowance, refund, or other benefit payable under the Retirement Fund;

"Employee" means any person who is engaged to work or works under a contract of service or apprenticeship with an employer, whether by way of manual labour, clerical or professional work, or otherwise;

"Employer" means any person who pays or is liable to pay to any person (being an employee within the meaning of this subsection) any earnings as an employee;

"Government Actuary" includes any person for the time being authorised (whether by delegation by him or otherwise) to exercise or perform any of the powers or functions of the Government Actuary;

"Member" means a person who has become admitted to membership of the Retirement Fund and who is or may become entitled to benefits under the Retirement Fund;

"Minister" means the Minister of Finance;

"Person", in relation to an employer, includes a company or other body corporate, whether incorporated in New Zealand or elsewhere, and a public body; and also includes an unincorporated body of persons, a partnership, an association of persons carrying on a joint undertaking, and a Government Department;

"Permanent Incapacity" means permanent physical or mental incapacity suffered by any person that is of such an extent that, having regard to the previous employment and other characteristics of that person, that person is unlikely to have a significant earning capacity in the future;

"Receivership Date" means the date upon which the Government Actuary in exercise of his powers under the Act suspends the Trustees of the Retirement Fund and puts a Retirement Fund into statutory receivership;

"Retirement Fund" means the fund established for the purpose of pooling contributions made by the Employer(s) (if any) of any members and/or any members to provide retirement and similar benefits to those members or the beneficiaries of those members;

"Retirement Income Fund" means a Retirement Fund governed by conditions that require every benefit in excess of the Specified Cash Benefit of every member of the Retirement Fund to be taken in the form of an income dependant on the life of the member and (if so stated in the trust deed) after the death of the member, on the life of a surviving spouse or a dependant of the member, and that do not enable any member to commute to, or to capitalise the benefits into, a lump sum which exceeds any amount, the payment of which would reduce the income otherwise payable by 25 per cent.

"Retirement Lump Sum Fund" means any Retirement Fund that is not a Retirement Income Fund.

"Solicitor" means a Practitioner as defined in the Law Practitioners Act 1982 holding a current Practising Certificate and who is a principal of a firm of legal practitioners or a sole practitioner;

"Specified Cash Benefit" means (with regard to each member of a scheme which at 30 June 1988 is classified by the Government Actuary under the Superannuation Schemes Act 1976 as either:

(a) a subsidised employee pension superannuation scheme; or

(b) an unsubsidised employee pension superannuation scheme;

and which has always been part of a Retirement Fund classified as a Retirement Income Fund by the Government Actuary under this Act from which no benefit has been paid to that member other than by way of transfer to another registered Retirement Income Fund) the greater of:

(i) the maximum amount which the member could have received as a lump sum if the Retirement Fund were to be wound up on 30 June 1988; and

(ii) the maximum amount which the member could have received if the member had left the Retirement Fund by reason of withdrawal or retirement as at 30 June 1988; and

in respect of which sufficient information has been provided to the Government Actuary before 31 March 1989, and which the Government Actuary has approved.

A members Specified Cash Benefit cannot be apportioned between two or more registered Retirement Income Funds and will be deemed to be reduced to zero for taxation purposes immediately after any payment other than by way of transfer to another Retirement Income Fund is made to or in respect of that member under the Retirement Income Fund.

[Relevant only for modified E/T/T]

"Statutory Receiver" means the person appointed by the Government Actuary pursuant to the Act to manage the affairs of the Retirement Fund in accordance with clause 15;

"Trustees" means the persons who are designated as such in the Trust Deed or any amendment thereto;

"Trust Deed" or "Deed" means this trust deed;

"Vested Benefit" means that part of Accrued Benefits to which a member has an absolute right.

1.2 In this Deed where the context permits words denoting the singular include the plural and vice versa in each case.

1.3 Any reference to any Statute shall include any subsequent statutory modification or re-enactment thereof or any Act passed in lieu thereof and for the time being in force and any regulations made thereunder.

1.4 For the purposes of this Deed, the Retirement Fund shall be deemed to operate on the principle of unallocated funding if the contributions to the Retirement Fund are not allocated on a defined basis to individual members.

2. INVESTMENT AND BORROWING POWERS

2.1 Subject to sub-clauses 2.2, 2.3, 2.4, 2.5 and 2.6 of this clause all money of the Retirement Fund which is available for investment shall be invested in any manner that would be authorised by the Trustee Act 19??
[This will include the borrowing powers of the Trustees.]

[The current Act is expected to be amended. The new replacement Act has had its first reading and is currently with the Select Committee].

2.2 No investment of the Retirement Fund shall be made on terms that are other than normal arms-length commercial terms.

2.3 No investment of the Retirement Fund can be made in any securities or investments issued or granted by -

(a) any member or any employer of any member; or

(b) any person who is a relative of or person associated with any such member or employer.

if the then total market value of such investments would exceed 10% of the market value of all the investments of the Retirement Fund.

2.4 No funds of the Retirement Fund can be used directly or indirectly in any business in any manner other than by an investment authorised by or under this clause 2.

2.5 Where any investment that has been made before the Act came into effect, and was in accordance with the Superannuation Schemes Regulations 1983, that investment may be retained until:

(a) its maturity, contractual repayment, sale or other disposal; or

(b) the 27th day of August 1996;

whichever is the earlier, without any effect on the registration of the Retirement Fund.

2.6 For the purposes of this Clause, the expressions "business", "relative" and "associated person" shall have the same meanings as in the Income Tax Act 1976.

3. POWERS OF THE TRUSTEES

3.1 The persons named as Trustees in the Deed shall be the first Trustees of the Retirement Fund.

3.2 The Trustees may meet for the despatch of business adjourn and otherwise regulate meetings as they think fit.

3.3 The Trustees may open and operate on such bank accounts as they think fit.

3.4 The Trustees may enter into such contracts of insurance as they may in their discretion deem desirable to ensure payment of any benefits under this Deed.

3.5 The Trustees may appoint from time to time any person or agent to enable the carrying out of the trust purposes, powers, authorities or discretions and may pay suitable renumeration to such person or agent.

3.6 The Trustees shall not be liable for:

(i) any losses other than those arising from their own wilful neglect or default, or

(ii) any act done bona fide in conformity with the decision of the Trustees hereunder, or

(iii) the neglect or default of any solicitor, banker, accountant, broker or other agent or officer employed in good faith by the Trustees.

3.7 The Trustees shall be indemnified against all claims costs losses expenses and liabilities incurred in the execution

of their duties except in the case of wilful neglect or default on the part of the Trustees and shall have a lien on the Retirement Fund for such indemnity.

3.8 The Trustees shall keep minutes of resolutions in a book provided for that purpose together with records of Members in such form as they may determine.

3.9 The Trustees shall keep account of the money received and disbursed and a statement of account shall be made up annually as at the balance date of the Retirement Fund in each year. The accounts shall be audited by an auditor appointed by the Trustees. A copy of the annual accounts and balance sheet and of the auditors report shall be furnished to all Employers who have paid contributions to the Retirement Fund in that financial year.

3.10 All Employers who have paid contributions to the Retirement Fund in that financial year and Members shall provide the Trustees with such information as the Trustees shall require in order to fulfil their duties under this Deed.

4. ACCOUNTS - ACTUARIAL EXAMINATION

4.1 If the Retirement Fund does not operate on the principle of un-allocated funding the Trustees shall maintain:

(a) A separate members account in the name of each member to which shall be credited contributions made by or in respect of that Member in terms of this Deed together with interest at the rate declared by the Trustees and transferred from the General Account.

(b) The Trustees shall maintain a General Account to which shall be credited any income, capital gains, upward revaluation of property or receipts which are not directed to be credited to Members accounts and to which there shall be debited capital losses, downward revaluations of property, administrative expenses, any costs of death or disablement insurance and interest credited to Members accounts and to the Reserve Fund.

(c) The Trustees shall maintain a Reserve Fund to which shall be credited:

(i) Interest at the rate declared by the Trustees and transferred from the General Account.

(ii) Any benefits which remain unclaimed following a period of six (6) years from the date on which the benefit was payable.

(iii) All benefits available on the leaving of a Member and not required under this Deed to be paid to the Member or his dependants in accordance with the provisions of this Deed.

(iv) All benefits forfeited in terms of Clause 7.1 and not applied for the benefit of dependants.

(v) Other money not required for the payment of benefits from the Retirement Fund.

(d) The Reserve Fund or such part as the Trustees may decide may be applied from time to time for the following purposes:

(i) Meeting any of the expenses of the Retirement Fund;

(ii) Meeting all or part of the contributions to the Retirement Fund;

(iii) Increasing the retirement benefits of all Members on an equitable basis;

(iv) Providing benefits other than retirement benefits for all Members of the Retirement Fund on an equitable basis;

(v) Providing personal benefits for Members or their dependants in the case of hardship.

(e) The rate at which interest shall be credited to members accounts and to the Reserve Fund shall be as determined from time to time by the Trustees having regard to the earnings of the Retirement Fund. For the purposes of this Clause interest shall be credited as at the annual balance date of the Retirement Fund in each year except in the case of a Member's retirement, death, permanent incapacity or leaving service in which case interest shall be credited as at that date.

4.2 If the Retirement Fund operates on the principle of unallocated funding or provides benefits in the form of pensions paid under the Retirement Fund;

(i) the financial position of the Retirement Fund shall be examined and reported on by an Actuary at least once every three years;

(ii) a copy of the report of the Actuary shall within three months after the date at which the financial position of the Retirement Fund was examined be provided by the Trustees to the Government Actuary;

(iii) a simplified copy of the report of the Actuary certified by the Actuary shall, as soon as practicable, be provided to each Member. The report shall show :

(a) the extent to which the vested benefits are covered by the assets held; and

(b) the extent to which the accrued benefits are covered by the assets held; and

(c) any recommendation as to future contribution rates.

(iv) Any benefits which remain unclaimed following a period of six (6) years from the date on which the benefit was payable or was due to commence being paid shall be forfeited to the Retirement Fund.

4.3 If the Retirement Fund does not operate on the principle of unallocated funding and provides pensions paid under the Retirement Fund, the Government Actuary may from time to time waive the requirements for an actuarial examination and report.

5. ADVICE TO MEMBERS OF DETAILS OF RETIREMENT FUND

5.1 A member shall have the right:

(a) to peruse a copy of the Trust Deed at any reasonable time and to obtain a copy for a reasonable fee;

(b) to receive a statement of the amount of the member's own accrued benefits as at the close of the preceding financial year;

(c) to receive a statement of the member's own withdrawal benefit as at the close of the preceding financial year.

5.2 A person shall, before his entry to membership of the Retirement Fund be advised in writing of -

(a) brief details of the Retirement Fund;

(b) a member's principal rights and benefits;

(c) any charges or fees that may be imposed;

(d) the rates or amounts of contributions payable and any maximum or minimum rates or amounts which are applicable;

(e) the right to receive the information referred to in clause 5.1.

5.3 A person shall before his entry to the Retirement Fund be given a copy of the last trustees annual report required under Clause 10 of the Second Schedule to this Act; or, if there is no such report, then the information stated in Clause 10(1)(g) and (h).

6. NO ALIENATION OF MEMBERS RIGHTS PERMITTED

6.1 No member may assign, charge, alienate or borrow against the security of the members benefits under this Deed.

6.2 No person shall have the right to recover from a member's benefit any money owing to that person, or any monetary loss suffered by that person.

7. BANKRUPTCY OF MEMBER

7.1 In the event of a member becoming bankrupt then all benefits to which such member is entitled under this Deed shall be forfeited to the Retirement Fund provided that the Trustees shall apply in respect of such member an amount not exceeding the amount of the benefit which has been forfeited in accordance with the provisions of this Deed.

8. INCAPACITY OF MEMBER

8.1 In the event of a member becoming physically, mentally or otherwise incapable of managing the Member's own affairs the Trustees shall pay the Member's benefits in accordance with the decision of any committee duly appointed to manage the affairs of the Member or in the event of no such committee being appointed the Trustees shall apply the benefits for the maintenance support or otherwise for the benefit of the Member or such of the Member's dependants as the Trustees may in their discretion determine.

9. AMENDMENT TO TRUST DEED

9.1 No amendment to this Trust Deed shall have effect unless all of the provisions of the trust deed as amended would comply with the Act and any regulations made under the Act, and the Government Actuary has approved the amendment.

9.2 The Trustees shall supply to the Government Actuary 2 copies of any amendment to this Trust Deed, and shall notify the Government Actuary of the date of adoption of any such amendment.

9.3 No amendment to this Trust Deed shall be made without the written consent of every member whose interest in the Retirement Fund at the date of the amendment could be reduced or adversely affected by the amendment.

10. ANNUAL REPORTS

10.1 The Trustees of the Retirement Fund shall provide the following to the members within 3 months after the end of each financial year of the Retirement Fund -

(a) a statement of numerical changes in the membership of the Retirement Fund during the financial year.

(b) Audited accounts in respect of the Retirement Fund, which shall include -

(i) a revenue account or a statement of Retirement Fund transactions;

(ii) a balance sheet or a statement of assets and liabilities;

(iii) for every Retirement Fund where an actuarial examination and report is required under clause 4.2, a statement as to whether the rates or amounts of contributions paid are in accordance with the recommendations contained in the most recent such report;

(iv) an auditor's report which report shall cover the matters contained in clause 10.5 below.

(c) A certificate by the Trustees on whether the value of the assets of the Retirement Fund exceeds the total withdrawal benefits of all members.

(d) A report by the Trustees on whether the contributions required to be made to the Retirement Fund by members and employers (if applicable) were paid during the financial year in accordance with the terms of this Trust Deed.

(e) A copy of a statutory declaration signed by the employer(s) (if any) and the Trustees on whether the investments and any borrowings of the Retirement Fund conformed with the requirements of the Act and any regulations made under the Act at all times throughout the year.

(f) A report on the investment performance of the Retirement Fund; and, in the case of a Retirement Fund which does not operate on the principle of unallocated funding, a statement of the rate at which interest was allocated to members.

(g) Any changes to benefit payments and conditions, and contributions, under the Retirement Fund.

(h) Names of, and any changes in, trustees; and every administration manager, investment manager, insurer, actuary, auditor and solicitor (as applicable) acting for or advising the Trustees during the year.

(i) The address of the Trustees for enquiries.

10.2 For the purposes of clause 10.1(b) of this Section, the auditors report may, if the Retirement Fund is fully managed and invested by any one organisation which provides to the Government Actuary audited accounts in respect of its total Retirement Fund business, be replaced by a certificate from that organisation to the same effect.

10.3 The Trustees shall provide the Government Actuary within 3 months after the end of the financial year of the Retirement Fund, a copy of the Trustees report to the members for that financial year.

10.4 If the Government Actuary provides forms for summarising the information contained in the trustees report that is to be forwarded to the Government Actuary under clause 10.3, the Trustees shall use those forms, but the failure of the Government Actuary to provide such forms shall not alter the obligations of the Trustees to make the reports.

10.5 The auditor's report referred to in clause 10.1 shall be a report to the Trustees on the accounts of the Retirement Fund examined by the auditors, including every balance sheet or statement of assets and liabilities of the Retirement Fund and every revenue statement or statement of fund transactions of the Retirement Fund, and the report shall state:

(a) Whether the auditors have obtained all the information and explanations that they have required;

(b) Whether in the auditor's opinion, proper accounting records have been kept by the Retirement Fund, so far as appears from their examination of those records;

(c) Whether, in the auditor's opinion, according to the best of the information and the explanations given to the auditors and as shown by the books of the retirement fund -

(i) the balance sheet or statement of assets and liabilities is properly drawn up so as to give a true and fair view of the state of the Retirement Fund's affairs as at the end of its financial year; and

(ii) the revenue statement or statement of fund transactions is properly drawn up so as to give a true and fair view of the results of the Retirement Fund for its financial year;

(d) Whether, in the auditor's opinion, the investments conform with the requirements of clause 2.3 and that in all respects, apart from investments, the Retirement Fund was operated during the year in compliance with this Trust Deed.

11. TERMINATION

11.1 No part of the assets of the Retirement Fund may revert to any Employer in the event of any total or partial termination of the Retirement Fund without the prior written consent of the Government Actuary.

11.2 The amount in respect of each Member may be transferred for the Member's benefit to another registered Retirement Fund.

11.3 The Trustees shall as soon as practicable after the total or partial termination of the Retirement Fund advise the Government Actuary that the distribution of the assets has been completed.

12. BENEFIT PAYMENTS

12.1 The value of the benefit payable to or in respect of a member on ceasing to be a member for any reason shall not be less than the member's own contributions to the Retirement Fund together with any contributions made by the member to any previous Retirement Fund from which the member's benefits have been transferred.

12.2 Benefits under this Deed shall be retained in the Retirement Fund until -

(i) the member retires; or

(ii) the member dies; or

(iii) the member is permanently incapacitated; or

(iv) the member leaves the service of the members employer (if applicable); or

(v) the member exercises his right to transfer part or all of the amount held for his benefit to another registered Retirement Fund.

13. RESERVE FUND

13.1 If the Retirement Fund does not operate on the principle of unallocated funding, it shall have a reserve fund.

13.2 Any such reserve fund shall consist of -

(a) benefits forgone when members cease to be eligible to contribute to the Retirement Fund;

(b) unclaimed benefits;

(c) income from the investments of the reserve fund;

(d) other money not required for the payment of benefits under the Retirement Fund.

13.3 The reserve fund shall be applied only towards the following purposes -

(a) meeting all or part of the contributions to the Retirement Fund,

(b) increasing the benefits payable under the Retirement Fund,

(c) payment of the expenses of the Retirement Fund,

provided that any such application shall be on an equitable basis.

14. NOTIFICATION TO GOVERNMENT ACTUARY OF ADDRESS AND CHANGES OF ADDRESS

14.1 Every person who gives or sends to the Government Actuary any notice or documents that such person is required or entitled to give or send to the Government Actuary under the Act or any regulations made under the Act shall, unless he has already done so, include in or with that notice or document a current postal address for that person to which correspondence may be sent.

15. RECEIVERSHIP OF RETIREMENT FUND

15.1 On the Receivership Date the Government Actuary shall appoint a Statutory Receiver of the Retirement Fund pursuant to the Act.

15.2 A Statutory Receiver shall, unless otherwise directed by the Government Actuary have all the powers, authorities and discretions vested in the Trustees by this Deed.

15.3 In the exercise of the Statutory Receiver's powers, authorities and discretions a Statutory Receiver shall comply with any lawful and proper directions given by the Government Actuary.

15.4 The Government Actuary shall fix the remuneration of such Statutory Receiver and direct payment thereof out of the Retirement Fund.

15.5 Unless otherwise directed by the Government Actuary all moneys received by a Statutory Receiver shall be held by the Statutory Receiver on trust for the Members of the Retirement Fund; and for meeting the debts of the Retirement Fund to persons other than members.

15.6 The Trustees shall assist the Statutory Receiver in the performance of the duties of the Statutory Receiver and shall pay to the Statutory Receiver any moneys arising from the Retirement Fund as directed by the Government Actuary or the Statutory Receiver.

15.7 Every Statutory Receiver shall be the Agent of each Member of the Retirement Fund, each Employer (if applicable) and the Trustees, and alone shall be responsible for the Statutory Receiver's action and, subject to Clause 15.3 above, the Statutory Receiver's remuneration, and the Government Actuary shall not incur any liability therefor or in respect thereof by reason of the Statutory Receiver's appointment.

15.8 The above powers shall be in addition to and not in substitution for the rights and powers conferred upon receivers by law except to the extent that such rights have been negatived by the Act.

15.9 Neither the Government Actuary nor any Statutory Receiver shall be liable by reason of any entry into possession to account in the manner of a mortgagee in possession of property pursuant to a mortgage or for anything except for any loss on realisation or for any default or omission for which a mortgagee in possession of property pursuant to a mortgage might be liable.

15.10 No person dealing with the Statutory Receiver or their agents shall be concerned to enquire whether the Government Actuary or Statutory Receiver have the necessary power to have assumed control of the Retirement Fund or to see the application of any moneys paid to the Government Actuary or any Statutory Receiver and in the absence of fraud on the part of such person, such dealing shall be deemed, so far as regards the safety and protection of such person, to be authorised hereby and to be valid and effectual accordingly and the remedy of the Trustees or Members of the Retirement Fund in respect of any irregularity or impropriety whatsoever in the exercise of such powers shall be in damages only.

THIRD SCHEDULE

Fee Schedule for Publication by Government Actuary in Gazette

(1) The fees payable for every application under section 5 of the Retirement Funds Act 1988 is $ plus $ for every hour in excess of the first half hour spent in considering the application.

(2) The fee payable for every application under section 6 of the Retirement Funds Act 1988 is -

(a) Where the application relates solely to the inclusion of a participating employer, $

(b) In any other case, $ plus $ for every hour in excess of the first half hour spent by the Government Actuary in considering the application.

(3) The fee payable for every application for the purpose of obtaining the receivership and/or termination of the Retirement Fund is $ plus $ for every hour in excess of the first half hour spent considering the application.

(4) The fee payable for the making of the annual report [under Second Schedule, Clause 10] of this Act in respect of every financial year ending on or after 31 March 1989 is:

(a) $ if audited accounts are required.

(b) $ in any other case.

plus $ for every participating employer in excess of 10 participating in the Retirement Fund in the financial year to which the annual report relates.

(5) For the purposes of subclause (2) and (4) of this regulation the expression "participating employer" means an employer who has entered into an agreement with the trustees of a Retirement Fund to participate in the Retirement Fund for the benefit of employees of the employer who are admitted as members of the Retirement Fund.