

In Confidence

Office of the Minister of Revenue

Chair, Cabinet Economic Development Committee

BUSINESS TRANSFORMATION RELATED KIWISAVER POLICY CHANGES FOR INCLUSION IN THE NEXT OMNIBUS TAXATION BILL

Proposal

1. This paper seeks the Cabinet Economic Development Committee's agreement to the Crown funding the payment of employer contribution amounts passed to KiwiSaver scheme providers until these amounts are received from the employer, as well as a number of other measures which would increase the administrative efficiency of KiwiSaver and enhance members' experience with the scheme.

Executive Summary

2. As part of Inland Revenue's Business Transformation programme, the administration of KiwiSaver is scheduled to be transferred into a new administrative system on 1 April 2020. Business Transformation provides the opportunity to enhance the administration of KiwiSaver and improve the KiwiSaver member experience. Ensuring that members receive the correct contribution amounts and facilitating the faster transfer of contributions would assist in achieving these outcomes.
3. The main change this paper recommends is to allow Inland Revenue to pass employer contribution amounts to KiwiSaver scheme providers, before the contribution amount has been received by Inland Revenue (essentially acting as a Government guarantee of these contributions). This would improve the administrative efficiency of KiwiSaver, as it would facilitate earlier transfers of contributions to KiwiSaver scheme providers; meaning members would receive the benefit of their contributions being invested with scheme providers sooner. It would also be consistent with the existing treatment of employee contributions and other PAYE deductions, such as those made for student loans and child support.
4. This paper also proposes the following technical policy changes to KiwiSaver settings:
 - 4.1 change the date the calculation of interest on employer and employee contributions commences, to align with the pay date a member's employer has reported;
 - 4.2 reduce the KiwiSaver provisional period (during which individuals who are automatically enrolled in KiwiSaver are provisionally allocated to a default KiwiSaver scheme) from 3-months to 2-months;
 - 4.3 reduce the maximum period an old scheme provider has to share information and transfer funds to a new provider when a member transfers schemes, from 35-days to 10-days;

- 4.4 allow members to change contribution rates through their scheme provider or Inland Revenue, rather than only through their employer;
 - 4.5 remove the 3-month grace period for members who have been incorrectly automatically enrolled in KiwiSaver, to gain New Zealand residence; and
 - 4.6 require employers to provide Inland Revenue with KiwiSaver information about a member's employer superannuation contribution tax rate and the income their contributions are calculated from.
5. All the changes proposed would be phased in so that system changes are aligned with Inland Revenue's Business Transformation timelines. This would mean the proposals would apply from 1 April 2020.
 6. If Cabinet agrees, necessary legislative amendments to give effect to the changes would be included in the next omnibus taxation Bill, which is scheduled for introduction in mid-2019.

Guarantee of employer contributions

7. Under current KiwiSaver settings, where an employee contribution has been deducted from a member's salary or wages but has not been paid, the amount is treated as having been received by Inland Revenue and is passed to the member's KiwiSaver scheme provider. The effect of this is the Crown funds the payment of the employee contribution until the amount is received from the employer, it also means in situations where the amount is never received by the employer these Crown funds are not recovered (effectively creating a Government guarantee of employee contributions and for simplicity will be referred to as such throughout the rest of the paper). This approach was adopted as it aligns with the treatment of other PAYE deductions, including for child support and student loans.
8. There is currently no comparable arrangement with employer contributions. This means that where an employer fails to pay an employer contribution amount, no contribution is paid to the member's KiwiSaver account and the member's savings would be adversely impacted as a result of their employer's late payment or non-payment.
9. The decision not to guarantee employer contributions when KiwiSaver was first introduced, is attributable to the fact they were considered an additional benefit "on-top" of a member's salary and wages. However, as the KiwiSaver regime has become more established, there has been a decline in any conceptual distinction between employer and employee contributions. The KiwiSaver Act 2006 now explicitly allows for employer contributions to form part of a total remuneration package (so long as the employee is receiving at least the minimum wage excluding the employer contribution in the total remuneration package). Employer contributions are also now generally understood by employees to be their money, similar to the way employee contributions deducted from salary or wages are.
10. The current state (with no guarantee of employer contributions) results in employer contribution taking on average 5-days longer to be transferred to scheme providers than employee contributions. This gap would increase once payday filing reforms, requiring employers to file employment income information with Inland Revenue

within 2 days of a payday (or within 10 days for employers with annual PAYE deductions of less than \$50,000), become compulsory from 1 April this year. As Inland Revenue would have KiwiSaver contribution information sooner, these reforms would allow employee contributions to be passed to scheme providers sooner after a member's payday. However, as the date that actual payments must be made to Inland Revenue is not changing, if a guarantee was not introduced, employer contributions would still be unable to be passed until the contribution amount was received.

11. Inland Revenue is also required to allocate resources to time consuming administrative reconciliation processes as a result of employer contributions not being guaranteed. These include allocation of part payments of employer contributions to employees' KiwiSaver accounts and employer contribution refund requests to KiwiSaver scheme providers (where an amount was incorrectly identified as an employer contribution and must be returned to Inland Revenue from the provider). These complex transfer processes also make it difficult for members to reconcile the amounts in their KiwiSaver account with the contribution amounts listed on their payslips.
12. I propose that the existing approach for employee contributions be extended to employer contributions – that is employer contributions would be guaranteed. This would mean these contributions would be able to be passed to scheme providers as soon as information from an employer had been filed with Inland Revenue, rather than having to wait until the contribution amount had been paid. This would facilitate the faster transfer of employer contributions to scheme providers, which would have flow on benefits for members, as contributions would be subject to market investment returns sooner. As contributions could be passed to scheme providers in full, it would also reduce confusion caused by complex reconciliation processes.
13. The guarantee would need to apply to both compulsory and voluntary employer contributions. A guarantee that only covered compulsory employer contributions would not recognise that voluntary employer contributions are generally understood by members as forming part of their remuneration, nor would it create the same administrative efficiencies (as it would require Inland Revenue to still hold some contributions until the contribution amounts were received). Given the number of employers making voluntary employer contributions is small, with voluntary employer contributions estimated to make-up only approximately 2% of all employer contribution in the year ending 30 June 2018, this would not have a significant impact on the proposed change.
14. Total levels of employer and employee contribution debt are comparable (as at 30 June 2018, \$18 million in employer contribution debt and \$24 million in employee contribution debt, since the commencement of KiwiSaver in 2007). This suggests that the existing guarantee of employee contributions has had limited behavioural impact on employers. Based on this precedent, as employer contributions are generally treated as forming part of an employee's remuneration, it would be expected that guaranteeing employer contributions would have a similar minimal behavioural impact on employers. That is, employers would not be less likely to pay these amounts. Inland Revenue monitors levels of unpaid employee and employer contributions and has existing recovery mechanisms and penalties that can be applied in relation to these debts. These would remain in place if a guarantee of

employer contributions was agreed to and could be used to maintain employer compliance levels.

Date calculation of interest payments commences

15. Once Inland Revenue has received notification that an employer has deducted KiwiSaver employee contributions or paid employer contributions, these contributions are held in Inland Revenue's KiwiSaver holding account. Inland Revenue pays interest on contributions that are held in this account, until they are forwarded to the member's KiwiSaver scheme.
16. When KiwiSaver was introduced it would not have been possible for Inland Revenue to collect the information necessary to calculate interest from the date of the payday deductions were made or employer contributions paid, without imposing significant compliance costs on employers. As a result, for the purposes of calculating the interest due, employee contributions are treated as received into Inland Revenue's holding account on the 15th day of the month in which the deduction is made by the employer. Employer contributions are treated as received on the first day of the month in which the money is actually received by Inland Revenue. These approaches result in the under and over payment of interest on employee contributions and the underpayment of interest on employer contributions.
17. As part of the payday filing reforms, outlined above in paragraph 10, Inland Revenue will receive employment income sooner after an employee's payday (this information would include KiwiSaver employee and employer contribution information). Based on the improved information available with payday filing, I propose that interest calculations on KiwiSaver employee contributions held by Inland Revenue should now be calculated from the pay date the employer has reported. If the proposal to guarantee employer contributions is agreed to, it is also proposed that interest on employer contributions is calculated from the member's payday. If a guarantee of employer contributions was not introduced, it would not be appropriate to commence interest calculations on these amounts from the member's payday. Under current settings, as employer contributions can only be passed to scheme providers when the amount has been received, if interest was calculated from a member's payday and there was delay in the contribution amount being received by Inland Revenue, this would create a risk that Inland Revenue would be required to pay interest on contributions for significant periods of time.

Reducing the KiwiSaver provisional period

18. When automatically enrolled in KiwiSaver, members are provisionally allocated to a default KiwiSaver scheme provider. If the member does not make an active choice to join a different KiwiSaver scheme within their first 3-months of membership, they will be treated as having offered to become a member of the default scheme to which they were provisionally allocated. This 3-month period is referred to as the provisional period and is distinct from the KiwiSaver opt-out period (which is between weeks 2-8 after a person is automatically enrolled in KiwiSaver).
19. Inland Revenue does not transfer the member's contributions to scheme providers until the end of the 3-month provisional period, meaning providers are unaware they have been allocated the member during this period. A consequence of this is providers are unable to contact these members until 3-months after they are enrolled

in KiwiSaver. Feedback from KiwiSaver scheme providers indicates by this time these members (who will be default allocated to a conservative fund type) have often become disengaged about decisions relating to KiwiSaver investment options.

20. I recommend the provisional period be reduced from 3-months to 2-months. This would allow KiwiSaver scheme providers to engage with members about investment options earlier, while retaining a 2-month provisional period would ensure that members wanting to actively choose a scheme still had the option to do so.
21. Reducing the provisional period from 3-months to 2-months, would mean that the period Inland Revenue would be required to hold members' initial KiwiSaver contributions could also be reduced from 3-months to 2-months. As a result, member's contributions would be invested with scheme providers sooner and the amount of interest on initial contributions paid by Inland Revenue would also reduce. Members would still have the opportunity to transfer between schemes after the provisional period ended.

Timeframe for transfer of member's information and funds to new scheme provider

22. When a KiwiSaver member decides to transfer schemes, the new scheme is required to notify the member's old scheme about the transfer. Arrangements with default KiwiSaver scheme providers require them to transfer information they hold on the member and the member's funds to the new scheme within 10-days. However, for non-default schemes the KiwiSaver Act 2006 provides that they have 35-days to fulfil this transfer process. I propose that this transfer period should be reduced to 10-days for all KiwiSaver schemes. Reducing the legislatively mandated period to 10-days would align timeframes for the transfer of information across all KiwiSaver scheme providers.

Changing employee contribution rates

23. Currently, members can only change their employee contribution rate by giving notice to their employer. However, employers may not be members' first point of contact on matters relating to their KiwiSaver account – this will often be their KiwiSaver scheme provider or Inland Revenue. This includes when members are considering what rate they should be contributing at to achieve their preferred retirement savings outcomes.
24. As contribution rate change applications cannot be made through a scheme provider or Inland Revenue this imposes unnecessary compliance costs on members (following a discussion with their scheme provider or Inland Revenue members would then have to contact their employer to change rates). These compliance costs may mean members will not follow through on contribution rate changes, that would have been in their financial interests.
25. I recommend, that in addition to existing processes, members should be able to change their contribution rate through their KiwiSaver scheme provider or Inland Revenue.

KiwiSaver invalid enrolments – residence grace period

26. Where a person who does not meet all the KiwiSaver enrolment criteria has been incorrectly enrolled, generally the KiwiSaver invalid enrolment rules apply and the person's membership will be terminated. However, there are some limited exceptions to the invalid enrolment rules. This includes situations where a person does not meet the criteria of being a New Zealand resident when enrolled in KiwiSaver, but gains New Zealand residence in the 3-month period subsequent to their enrolment.
27. This 3-month grace period was intended to reduce compliance costs for members and administrative costs for Inland Revenue, as individuals who became a New Zealand resident during the 3-month period would not have their account closed and then have to re-enrol again soon after (when they did meet the membership criteria).
28. However, in practice members who are invalidly enrolled on the basis of the residence ground, will not become a New Zealand resident within the requisite 3-month grace period. For example, non-residents enrolled in KiwiSaver are often individuals with temporary work visas, who have no intention of becoming New Zealand residents in the short-term. Being required to keep these accounts active during the 3-month grace period imposes an additional administrative burden on Inland Revenue and there is no benefit to the member (as their account will be closed at the end of the 3-month period).
29. As it has not operated as intended, I recommend the 3-month grace period for an individual to gain New Zealand resident status after being invalidly enrolled in KiwiSaver be removed. When a person does not meet the New Zealand resident requirement their account would immediately be closed, and they would have the opportunity to open a new account on gaining New Zealand residence. This would help ensure a consistent approach was adopted for people who were incorrectly enrolled in KiwiSaver.

KiwiSaver income and ESCT rate information

30. As part of the KiwiSaver on-boarding process, employers are required to provide Inland Revenue with information about new employees who have been automatically enrolled in KiwiSaver or existing employees opting-in to the scheme (this includes their personal information and IRD number).
31. To improve Inland Revenue's ability to ensure that KiwiSaver members are receiving the correct KiwiSaver contribution amounts and that these amounts are being taxed at the correct rate, I propose that employers should also provide the following information to Inland Revenue about new employees or existing employees where this information has changed:
 - 31.1 any difference between an employee's income for PAYE purposes and their income for the purpose of calculating KiwiSaver contributions (some amounts that are treated as income for PAYE are exempt from the definition of KiwiSaver salary and wages); and
 - 31.2 the employee's employer superannuation contribution tax (ESCT) rate.

32. Under current settings (where Inland Revenue is not provided with this information), if it appears amounts received from an employer may be incorrect, Inland Revenue will contact the employer to obtain this information. This imposes compliance costs on Inland Revenue and the employer. As it can take up to six weeks for contact to be made, where the employer has undercalculated the amount, this can also mean the employer will be subject to penalties. If this information was already provided by the employer, the number of contacts would decrease. Inland Revenue would also be able to be more accurate and efficient in detecting potential miscalculation of contributions and ESCT amounts. This would help ensure that member's savings were not impacted due to miscalculations and employers would be less likely to be subject to penalties.
33. To accurately calculate a member's contributions and deduct the correct amount of tax from employer contributions, employers already need to hold information on an employee's ESCT rate and their KiwiSaver salary and wage income. Therefore, the only change would be that employers would now be required to communicate this information to Inland Revenue. It is expected that any compliance costs associated with doing so would be minimal.
34. For new employees this information would be provided as part of the existing KiwiSaver new employee process. It is expected that updates to this information for existing employees would be infrequent (and would be provided using the same form as is used for new employees). Consistent with PAYE tax, members are subject to the same ESCT rate for the full income tax year, so this information would be provided once a year (or less frequently if the employee stayed on the same rate). And any differences between income for PAYE purposes and for KiwiSaver purposes, generally do not change during the course of an employment relationship (some examples of amounts not treated as income for KiwiSaver purposes include the value of accommodation, a benefit from an employer share scheme or a redundancy payment).

Consultation

35. The Treasury and the Ministry of Business, Innovation and Employment have been consulted on this paper. The Financial Markets Authority and KiwiSaver scheme providers have also been consulted on the proposals and support them.

Financial Implications

Guarantee of employer contributions

36. Introducing the guarantee is not expected to have an additional impact on the operating balance. Inland Revenue already recognise an expense for any write-offs and impairment in relation to KiwiSaver employer contributions - for the fiscal year ending 30 June 2018 the write-off was \$2.6 million (including interest and penalties). This is because the KiwiSaver employer contributions are currently treated as a receivable asset until paid, which is the same treatment as all other taxes and payments collected by Inland Revenue. The only change is that there may be a cash impact to the Crown if the receivable is uncollected, which would impact on net core Crown debt.
37. Employer contributions would be treated as public money for the purposes of the Public Finance Act 1989, to enable the transfer of employer contributions to scheme

providers prior to Inland Revenue receiving the contributions. Public money requires a permanent legislative authority, which is currently provided for in the KiwiSaver Act 2006 in respect of employee contributions only. If a guarantee of employer contributions is agreed to, this would need to be extended to employer contributions.

38. A single appropriation would be established for both employer and employee contributions to report public money spending. The Public Finance Act 1989 requires a permanent legislative authority to be managed and accounted for in the same way as an annual appropriation. Currently, there is no appropriation covering amounts of employee contributions paid out of public money. This new appropriation will be reported on in the 2019/20 Supplementary Estimates.
39. The KiwiSaver Act 2006 will also be amended so that the permanent legislative authority only applies to KiwiSaver contributions passed by Inland Revenue to KiwiSaver scheme providers from public money, not to the total amount of employee and employer contributions Inland Revenue passes to KiwiSaver scheme providers.

Other proposals

40. Financial implications related to aligning the calculation of interest on employee contributions with a member's payday would be expected to be negligible, as current over and under payments of interest should broadly offset. Calculating interest on employer contributions from a member's payday would increase interest payable. However, this would be more than offset by the faster transfer of employer contributions to scheme providers, resulting in an overall reduction in KiwiSaver interest payable of under \$400,000 per year.
41. As the proposal to reduce the provisional period from 3-months to 2-months would allow Inland Revenue to pass initial employee and employer contributions to scheme providers a month earlier, this would reduce the amount of KiwiSaver interest payable by Inland Revenue by under \$100,000 per year.
42. No other proposals in this paper are expected to have financial implications.

Compliance and Administrative implications

43. Although the proposals would improve the efficiency of Inland Revenue's administration of KiwiSaver and reduce compliance costs for KiwiSaver members, the changes would require communication to employers, KiwiSaver scheme providers, and some staff training. There would also need to be updates to public communications material.
44. The proposals would be phased in so that system changes are aligned with Inland Revenue's Business Transformation timelines which would improve efficiency. This would mean the proposals would apply from 1 April 2020, to align with the transfer of KiwiSaver into its new administrative system (START).

Legislative Implications

45. Implementing these proposals would require changes to the KiwiSaver Act 2006.

46. If approved, I propose including the legislative changes resulting from these recommendations in the next omnibus taxation Bill scheduled for introduction in mid-2019.

Impact Analysis

47. The Quality Assurance reviewer at Inland Revenue has reviewed the *Business Transformation related KiwiSaver refinements* RIA prepared by Inland Revenue, and considers that the information and analysis summarised in the RIA meets the quality assurance criteria.

Human Rights

48. The changes I am recommending in this paper are not inconsistent with the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993.

Gender Implications

49. There are no gender implications arising from the proposals in this paper.

Disability Perspective

50. The proposals do not affect people with disabilities any differently.

Publicity

51. I will make an announcement on the contents of the proposed omnibus taxation Bill, including these proposals, when the Bill is introduced in mid-2019. A commentary on the Bill will also be released at this time. Inland Revenue will include details of the new legislation in a *Tax Information Bulletin* after the Bill is enacted.

Proactive Release

52. I propose to delay the proactive release of this Cabinet paper in full and associated minutes until the introduction of the proposed omnibus taxation Bill, which necessary legislative changes to give effect to these changes will be included in. The expected introduction date for this Bill is mid-2019.

Recommendations

The Minister of Revenue recommends that the Cabinet Economic Development Committee:

Guarantee of employer contributions

1. **agree** to Inland Revenue paying an amount of employer contribution out of public money to a KiwiSaver scheme provider in advance of the contribution amount being received, but where an employer has filed information with Inland Revenue that an employer contribution has been made.
2. **note** that an appropriation is required to make such payments out of public money.
3. **agree** to establish a permanent legislative authority enabling Inland Revenue to transfer employer contribution amounts to KiwiSaver scheme providers before the contribution amount has been received.
4. **agree**, that if you agree to recommendation 3, to combine the permanent legislative authority established under that recommendation with the existing permanent legislative authority in section 73(3) of the KiwiSaver Act 2006 (which applies to the

transfer of employee contributions to KiwiSaver scheme providers) into a single permanent legislative authority.

5. **agree** to provide in the KiwiSaver Act 2006 that the reporting required under section 11(2) of the Public Finance Act 1989 in respect of the permanent legislative authority in recommendation 4 be limited to the amount of KiwiSaver contributions paid by Inland Revenue to KiwiSaver scheme providers in advance of contribution amounts being received from employers (not the total amount of employee and employer contributions Inland Revenue pays to KiwiSaver scheme providers).
6. **agree** that the legislative implications of the proposed change in recommendations 1-5 be included in amendments to the KiwiSaver Act 2006.
7. **agree** that, provided the necessary legislative amendments have been passed and come into force, the financial implications associated with the proposed change in recommendations 1-5 be included in the 2019/20 Supplementary Estimates.

Other changes

8. **agree**, that if you agree to recommendation 1, to interest calculations on employer contributions held by Inland Revenue commencing from the pay date a member's employer has reported.
9. **agree** to interest calculations on employee contributions held by Inland Revenue, commencing from the pay date a member's employer has reported.
10. **agree** to reduce the provisional period (that applies to members who are automatically enrolled in KiwiSaver) from 3-months to 2-months.
11. **agree**, that if you agree to recommendation 10, to the period that Inland Revenue must hold initial KiwiSaver employee and employer contributions being reduced from 3-months to 2-months.
12. **agree** to the period a scheme provider has to share member information and transfer funds to a new provider when a member transfers schemes being reduced from 35-days to 10-days.
13. **agree** to KiwiSaver members being able to change contribution rates through their scheme provider or Inland Revenue (in addition to their employer).
14. **agree** to the removal of the 3-month grace period, for people who were incorrectly enrolled in KiwiSaver, to gain New Zealand residence.
15. **agree** to employers providing the following information to Inland Revenue about new employees and existing employees where this information has changed:
 - 15.1 the income amount members' contributions are calculated from; and
 - 15.2 an employee's employer superannuation contribution tax (ESCT) rate.

Legislative vehicle

16. **agree** that legislation to give effect to the changes recommended in this paper be included in the next taxation omnibus Bill for 2019.
17. **invite** the Minister of Revenue to instruct Inland Revenue to draft the necessary amendments to give effect to the changes recommended in this paper.

Authorised for lodgement

Hon Stuart Nash
Minister of Revenue