Treasury Report: KiwiSaver Implementation Process and Further Design Details

Date:	8 July 2005	**Treasury Priority:**	**High**
Security Level:	IN-CONFIDENCE	**Report No:**	T2005/1391

Action Sought

	Action Sought	Deadline
Minister of Finance	**Agree** to the recommendations **Refer** to Ministers of Housing and Education	5:00 pm Monday, 11 July
Minister of Commerce	**Agree** to the recommendations	5:00 pm Monday, 11 July
Associate Minister of Finance (Hon Trevor Mallard)	**Note**	None
Associate Minister of Finance (Hon David Cunliffe)	**Note**	None

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
	Senior Analyst, Markets, Infrastructure & Government, The Treasury			✓
	Senior Policy Analyst, Regulatory and Competition Policy Branch, MED			

Enclosure: **No**

8 July 2005 SH-13-0-7

Treasury Report: KiwiSaver Implementation Process and Further Design Details

Executive Summary

We are due to meet with you at 5:00 pm on Monday, 11 July 2005 to discuss the implementation process for KiwiSaver and further design details.

Implementation Process

We expect to provide initial drafting instructions for KiwiSaver to the Parliamentary Counsel Office (PCO) before the end of July. Until these instructions are received, PCO will not be in a position to advise when introduction may be feasible. However, there is a risk that introduction this year may be unlikely given the length and complexity of the legislation, and the election period.

Cabinet approval would be desirable where changes are being sought to existing Cabinet decisions or where significant new policy is being made. These areas would include the imposition of an upper age limit, the conversion mechanism and the employer exemption from the automatic enrolment provisions. Hence, it would be desirable to obtain Cabinet approval in these areas before mid August, if possible, to ensure that the legislative drafting process is not delayed.

If the KiwiSaver legislation is passed by September 2006 then the indicative key dates and events are as follows:

- Request for tender proposal (Feb 06 – Apr 06).
- Evaluation and approval of successful fund providers (May 06 – late Oct 06).
- Implementation by successful fund providers (Nov 06 – 31 Mar 07).
- Printing and distributing information packs (Feb 07 - Mar 07).

Legislation is only part of the implementation process. Any delays in the passage of the KiwiSaver legislation would reduce the time available for the tender, provider implementation and the preparation of communication material and may risk the 1 April 2007 start date.

Conversion Mechanism

Cabinet has agreed that a mechanism would be provided to assist existing registered superannuation schemes (RSS) convert into KiwiSaver schemes [Cab MIN (05) 15/2 paragraphs 2 & 3 refer]. The converted scheme would meet all the characteristics of the KiwiSaver scheme and would be eligible for the fee subsidy, the upfront contribution of $1000 and the housing deposit subsidy (subject to eligibility). At that time, you considered but rejected the option of allowing RSS to partially convert to a KiwiSaver scheme by establishing a KiwiSaver section within the scheme which members could voluntarily join.

You asked us to consider ways to facilitate RSS conversion. Existing legislation prohibits any change to an RSS that may reduce member's rights and benefits, including postponing the payment of member benefits, without 100% member consent. We had been considering diluting the need to obtain 100% member consents as a way of facilitating RSS converting into KiwiSaver schemes. However, less than 100% member consent would weaken investor protections without increasing the likelihood of conversions given RSS have significantly different terms and conditions from those of KiwiSaver. This view is shared by the Government Actuary, Investment Savings and Insurance Association of New Zealand (ISI) and the Association of Superannuation Funds of New Zealand (ASFONZ).

Instead, it may be preferable to allow RSS to establish a discrete section within their RSS that meets the KiwiSaver criteria, permits members to voluntarily transfer to that "KiwiSaver" section and requires employers to automatically enrol new permanent employees into that section. This option would reduce the incentive for employers or trustees to wind-up RSS, increase conversions and thereby increase the fiscal cost, and require employers and trustees to deal with two different types of members.

Employer Exemption from the Automatic Enrolment Provisions

You agreed to officials doing further work on ways to increase the number of employers who could qualify for the employer exemption from the automatic enrolment provisions given industry concern that few, if any, employers would be eligible for the exemption [T2005/1099 refers].

Employers with existing RSS are only eligible for the exemption from the automatic enrolment provision if their schemes:

- are portable;
- are open to all permanent new employees; and
- involve total contribution of at least 4% of gross salary that vest within two years.

Our earlier fiscal cost estimates assumed that 20% of employer schemes would qualify for this exemption and hence reduce the aggregate fiscal cost by around $20 million over the forecast period. However, a large number of existing defined contribution schemes will not meet these criteria given the low level of minimum prescribed contributions for members and employers and longer vesting periods.

Officials have considered a range of options for modifying the criteria. On balance, officials recommend that the 4% be based on the incentive for most members to contribute at least 4% in total (minimum prescribed member contribution plus the maximum employer contribution) and the vesting period be increased from two years to five years. For example, the State Sector Retirement Savings Scheme (SSRSS) would qualify on this proposed criteria as members are required to contribute at minimum 1.5% of salary and the government, as employer, is willing to match member contributions up to a maximum of 3% so the contribution incentive in this case is 4.5% of salary.

The number of employer schemes and hence employees affected by the employer exemption from the automatic enrolment provisions is uncertain and partly dependent on what decisions you make on the conversion mechanism. Hence, our earlier fiscal estimates are likely to be appropriate if around 20% of employers qualify for the employer exemption from the automatic enrolment provisions. The fiscal cost would be higher if less employers are eligible for the exemption.

Other

There are a range of other issues where we are seeking your policy authority in order to prepare drafting instructions.

Inland Revenue Department and Housing New Zealand Corporation have been consulted in the preparation of this report.

Recommended Action

We recommend that you:

Minister of Finance

Implementation Process

a **note** that PCO prefers your sign-off on our initial legislative drafting instructions;

b **agree** that you intend to sign off the initial drafting instructions to PCO when submitted to you in late July;

Agree/disagree.

c **note** that if the KiwiSaver legislation is introduced in early 2006 then the commitment of the Government will be needed to ensure it is passed in time to ensure a 1 April 2007 start date;

Authority

d **note** that you are required to consult with the Ministers of Education and Housing in making detailed design decisions;

e **refer** this report to the Ministers of Education and Housing;

Yes/no.

Conversion Mechanism

f **agree** that RSS should be able to convert by:

- establishing a discrete section within their scheme that meets the minimum KiwiSaver criteria;
- permitting members individually to voluntarily transfer to that section; and
- requiring employers to automatically enrol new permanent employees into that “converted” section;

Agree/disagree.

g **agree** that members of “converted” sections would qualify for the $1000 upfront government contribution, fee subsidy and housing deposit subsidy;

Agree/disagree.

h **agree** that, if the member consents, all or a portion of the member’s existing entitlements can be transferred to the “converted” section;

Agree/disagree.

Employer Exemption from the Automatic Enrolment Provisions

i **agree** that the 4% total contribution criteria for the employer exemption from the automatic enrolment provisions be changed to a requirement that the minimum prescribed amount the employee must contribute plus the maximum employer contribution for all employees must be at least 4% of gross salary;

Agree/disagree.

j **agree** that the maximum vesting period for the employer exemption from the automatic enrolment provisions be extended from two years to five years;

Agree/disagree.

Interest Paid by the Central Administrator

k **agree** that the payment of interest by Inland Revenue will extend to amounts held by the central administrator and refunded to a contributor;

Agree/disagree.

l **agree** that the Commissioner of Inland Revenue will not be obliged to pay interest on refunded amounts if the amount of interest to be paid is five dollars or less;

Agree/disagree.

m **agree** that for the purposes of calculating interest contributions will be treated as having been received by Inland Revenue on the 15th of the month of deduction, rather than on receipt;

Agree/disagree.

Housing Issues

n **note** that the individuals can withdraw their funds once to purchase a first home after participating for a minimum of three years;

o **agree** that the regulations or specification agreements with providers prescribe the detailed policy of eligibility for housing withdrawal, such as “first home buyer” and “primary place of residence”;

Agree/disagree.

p **agree** that an applicant for the housing withdrawal or housing deposit subsidy supply a statutory declaration that they meet the “first home buyer” test and that the housing deposit subsidy and/or housing withdrawal is for the purchase of their “primary place of residence”;

Agree/disagree.

q **agree** that the same definition of a “first home buyer” should apply to the housing withdrawal and housing deposit subsidy for consistency;

Agree/disagree.

r **confirm** that it be a requirement for housing withdrawal recipients to use the funds to buy a house as their “primary place of residence”;

Yes/no.

s **agree** that the “primary place of residence” be extended to include land purchased with the intention of building a first home and shares conferring a right of use or occupation;

Agree/disagree.

t **agree** that there be a reasonable timeframe for first occupation of a “primary place of residence” and justified exceptions from this reasonable period be set in regulations;

Agree/disagree.

u **agree** that there be two different tests for the three year requirement: one for the housing withdrawal based on participation and one for the housing deposit subsidy based on contributions;

Agree/disagree.

v **agree** that the three year contribution period for the housing withdrawal be based on participation and commence on the 15th of the month in which the deductions were first made to be consistent with interest calculations;

Agree/disagree.

w **agree**, subject to consultation with providers, that providers be required to keep records of a member’s start date and whether a housing withdrawal has been made, and transfer such records to another provider when a member transfers;

Agree/disagree.

x **agree** that KiwiSaver members apply to the Trustee for the housing withdrawal;

Agree/disagree.

y **agree** that Housing New Zealand Corporation administer the housing deposit subsidy;

Agree/disagree.

z **agree**, subject to consultation, that the housing withdrawal and housing deposit subsidy be paid to the member’s solicitor when the sale and purchase contract becomes unconditional;

Agree/disagree.

Fund Withdrawal Tax

aa **agree** that vested employer contributions be excluded from the fund withdrawal tax rules in the Income Tax Act where the contributions form part of a KiwiSaver withdrawal for a first home, including if from a “converted” section of a RSS;

Agree/disagree.

Minister of Commerce

Conversion Mechanism

bb **agree** that RSS should be able to convert by:

- establishing a discrete section within their scheme that meets the minimum KiwiSaver criteria;
- permitting members individually to voluntarily transfer to that section; and
- requiring employers to automatically enrol new permanent employees into that "converted" section;

Agree/disagree.

cc **agree** that members of "converted" sections would qualify for the $1000 upfront government contribution, fee subsidy and housing deposit subsidy;

Agree/disagree.

dd **agree** that, if the member consents, all or a portion of the member's existing entitlements can be transferred to the "converted" section;

Agree/disagree.

Employer Exemption from Automatic Enrolment

ee **agree** that the 4% total contribution criteria for the employer exemption from the automatic enrolment provision be changed to a requirement that the minimum prescribed amount the employee must contribute plus the maximum employer contribution for all employees must be at least 4% of gross salary;

Agree/disagree.

ff **agree** that the maximum vesting period for the employer exemption from the automatic enrolment provisions be extended from two years to five years.

Agree/disagree.

	Kirstie Hewlett
Senior Analyst, Markets, Infrastructure & Government	Manager, Business Law
for Secretary to the Treasury	Regulatory and Competition Policy Branch
	Ministry of Economic Development

Hon Dr Michael Cullen	**Hon Pete Hodgson**
Minister of Finance	Minister of Commerce

Treasury Report: **KiwiSaver Implementation Process and Further Design Issues**

Purpose of Report

1. This report updates you on the implementation process and risks around the KiwiSaver timeline and seeks your agreement on further policy issues, particularly the conversion mechanisms for existing registered superannuation schemes (RSS) and the employer exemption from the automatic enrolment provisions.

Analysis

Implementation Process

2. In order for implement KiwiSaver by the 1 April 2007 deadline, the following events must have occurred:

   - legislation introduced and passed;
   - providers (both default and active choice) selected and registered;
   - employers with existing schemes need to have time to apply for an exemption from automatic enrolment provisions;
   - existing RSS would need to have sufficient time to apply, obtain necessary member consents and amend trust deeds (6 months may be necessary if changes in trust deeds are required);
   - successful providers implement necessary system changes (six months lead time may be required);
   - investment statements need to be drafted;
   - time for printing and distributing information packs (Feb/Mar 07); and
   - time to provide existing employees with information to allow them to enrol in KiwiSaver so that contributions can commence from 1 April 07.

3. Many of these events cannot be started or completed until after the legislation is passed or the providers' selection is completed. For example, entering into contracts with providers would not be possible until the legislation is passed.

4. Hence, if KiwiSaver is introduced into the House in early 2006 then the commitment of Government to the legislation will be needed to ensure prompt passage.

Conversion Mechanism

Scheme Conversion

5. Currently, the Superannuation Schemes Act prohibits any change to an RSS that may reduce a member's rights and benefits, including postponing the payment of member

benefits, without 100% member consent. Hence, if one or many members withhold their consents then the relevant amendment cannot proceed.

6. Given that KiwiSaver would defer the payment of the members' benefits, it is likely that many members would object or withhold their consent to any conversion, especially given this would involve a significant change in member benefits. For example, members may be able to access their funds within a year or two with their existing RSS but may not be able to under a KiwiSaver scheme for possibly for over 30 years.

7. Officials had originally envisaged that conversion would involve less than 100% member consent and a wholesale transfer of all existing members of a scheme, making them subject to the KiwiSaver terms and conditions. However, overriding the need for all members to consent would undermine this important investor protection and assurance that the terms and conditions are not altered to the detriment of members.

8. The Government Actuary, the Investment Savings and Insurance Association of New Zealand (ISI) and the Association of Superannuation Funds of New Zealand (ASFONZ) have expressed extremely strong resistance to anything less than 100% member consent.

9. Even if a slightly lower consent requirement, say the consent of 75% of members, was introduced, it is unlikely that many schemes, if any, would be able to satisfy this requirement.

10. Therefore, conversion is only likely to be practical at the individual member level and with the prior consent of the individual member. Conversion could apply to both employer sponsored and retail schemes.

Individual Member Conversion

11. You previously rejected a conversion option directed at the individual level [T2005/662 refers]. However, if you wish to enable some form of conversion officials recommend considering conversion at the individual member level.

12. A conversion mechanism could be established that would enable RSS that wished to offer the members the option of complying with the KiwiSaver conditions the ability to establish a separate "KiwiSaver" section, within the scheme. The conversion would then involve:

- establishing a discrete section within their scheme that meets the minimum contribution amount and other KiwiSaver criteria;
- permitting members individually to voluntarily transfer to that section; and
- requiring employers to automatically enrol new permanent employees into that "converted" section but these employees could opt-out.

13. By transferring across members would obtain access to the $1000 sweetener, the housing deposit subsidy (where eligible) and the fee subsidy. Employees would still be able to choose a KiwiSaver scheme directly, if they wished.

14. The number of schemes that would establish a "converted" section and the number of members that would transfer across, if possible, are uncertain. However, the overall fiscal cost may increase from current estimates as a member of an RSS may be more likely to transfer to a "converted" section than open a KiwiSaver scheme, especially in the short-term.

15. In addition, members of the KiwiSaver converted scheme should have the ability to transfer across their benefit entitlements to reduce the need for employees to withdraw their funds.

16. ASFONZ and ISI were strongly supportive of giving RSS the option of establishing a KiwiSaver section as a practical way to manage the interface between KiwiSaver and existing schemes and reduce the risk of RSS wind-ups. However, ASFONZ were of the view that new employees should have the choice as to which section of the scheme they joined, rather than being automatically enrolled in the KiwiSaver section unless they opt out.

Employer Exemption from the Automatic Enrolment Provisions

17. At our meeting on 8 June, you agreed to officials doing more work, in consultation with industry, on the criteria for the employer exemption from automatic enrolment (given concerns that few, if any, employers would be eligible for the exemption).

18. One of the main areas of concern was the requirement that the employer plus employee contributions be 4%. ASFONZ advised that a large number of existing schemes would not meet the 4% contribution criteria, even though the employer may be making a significant investment in the scheme through payment of administration fees and/or an individual contribution to employees. According to the 2003 ASFONZ Survey of Superannuation Schemes, around 70% of employer sponsored defined contribution schemes allowed members to contribute variable rates.

19. Officials recommend that the 4% contribution rate be relaxed to allow employers who are already savings champions to continue contributing to their schemes while allowing them to benefit from the exemption to reduce their compliance costs from KiwiSaver.

20. There are a range of options for relaxing the 4% contribution rate requirement, including:

- reward any employer contribution, such as payment of fees by employers;
- lower the contribution rate - from 4% to say 2%; and
- focus on level of the contribution incentive - the minimum prescribed amount the employee must contribute plus the maximum employer contribution for all employees must be at least 4% of gross salary.

21. Rewarding any employer contribution would cover all employer-sponsored schemes no matter how small the employer contribution. In addition, where the employer contributes amounts other than as a percentage of salary, such as a contribution to fees, it is may be difficult to quantify the magnitude of this benefit.

22. The other two options recognise that most schemes would be unable to meet a mandatory 4% contribution for all members given many schemes allow low minimum member contribution rates.

23. The contribution incentive may be a more effective way of identifying good employer schemes than using a lower contribution rate, as a good scheme should encourage members to save at a higher rate.

24. On balance, officials recommend that the minimum prescribed amount the employee must contribute plus the maximum employer contribution for all employees must be at

least 4% of gross salary. For example, the State Sector Retirement Savings Scheme (SSRSS) would qualify on this proposed criteria as members are required to contribute at minimum 1.5% of salary and the government, as employer, is willing to match member contributions up to a maximum of 3% so the contribution incentive in this case is 4.5% of salary.

25. The ASFONZ survey found that over 85% of defined contribution schemes had a vesting period of three or more years in duration. Officials recommend extending the vesting period from two years to five years to enable more employer schemes to be eligible.

26. Our fiscal cost estimates assumed that around 20% of employers would qualify for the employer exemption from the automatic enrolment provisions. New employees with these employers would not be caught by the automatic enrolment provisions and thereby result in a fiscal cost saving of around $20 million over the forecast period. To the extent that the changes in the employer exemption increase the number of employees not subject to automatic enrolment provisions, the fiscal cost of KiwiSaver may decrease.

27. A number of employer-sponsored schemes require the completion of a minimum period of service with the sponsoring employer before a new employee is eligible to join the scheme. A common “qualifying period” is 12 months but some stand-down periods are longer. The principal purpose of this restriction is to exclude seasonal workers, or persons employed for brief fixed terms, from an employer subsidy designed to encourage and reward permanent service.

28. Stand down periods would not qualify as the scheme being open to all permanent employees. Officials consider that schemes with stand down periods should not be eligible for the employer exemption as new employees are not offered an alternative superannuation scheme from day one.

29. ISI considered that most employer-sponsored schemes would still be ineligible for the employer exemption from the automatic enrolment provisions under the proposed changes to the criteria. Consultation indicated a strong preference for dropping the vesting requirement entirely and allowing stand down periods.

Interest Paid by the Central Administrator

30. You have agreed that Inland Revenue will pay interest on money held in the central administrator and that interest is to be calculated at the point at which the money leaves the central administrator rather than daily at a tax exempt rate [PAD2005/39, T2005/268 refers]. It is unclear whether this also extends to amounts held by Inland Revenue and later returned to a contributor, for example, in instances where Inland Revenue uses its discretion to refund contributions held in the holding pen when a late opt-out is accepted. Officials consider that interest should also be paid on amounts refunded due to the opportunity cost of the Crown holding the money.

31. However, officials consider that the Commissioner of Inland Revenue should not be obliged to pay interest if the amount of interest to be paid on refunded contributions is five dollars or less. This is consistent with current powers of the Commissioner in respect of small amounts of refunds contained in the Tax Administration Act 1994.

32. Our earlier report did not cover when the interest period should commence from. Given that the salary contribution for many will be deducted from a person’s salary or wages and held by the employer for up to 51 days (based on monthly filing where the payday falls on the first of the month) before Inland Revenue receives and is able to pass the

contribution on to the provider, the employee will suffer an opportunity cost. This suggests that interest should commence from the day after contribution is deducted from the employee's salary or wages. However, Inland Revenue does not hold such information and if this was requested the employer would incur compliance costs and extra administrative costs for Inland Revenue in collecting it.

33. Officials recommend an arbitrary rule be used for this purpose, as is the current approach for student loan deductions. The Student Loans Schemes Act 1992 rule has the effect that deductions received by Inland Revenue are credited back to the 15^{th} of the month of deduction. While this will still result in under and over payments of interest, it is likely to be the best solution available without imposing high compliance costs on employers and administrative costs on Inland Revenue.

Eligibility Criteria for Home Ownership Assistance

34. As you are aware, Cabinet has agreed that a housing deposit subsidy and housing withdrawal be available to KiwiSaver participants who are first home buyers. Also, the housing deposit subsidy will be available to existing RSS with employers who are exempted from automatic enrolment provisions [CAB Min (05) 13/9, paragraph 3.7 and CAB Min (05) 13/10 paragraph 2.3 refers].

35. To make decisions about eligibility for the housing withdrawal and the housing deposit subsidy, the deciding agency/trustee will need to be satisfied that the applicant meets the specified eligibility criteria. The applicant could supply a statutory declaration that they meet the criteria.

36. Regulations or the specification agreement with providers could prescribe the policy detail, such as the definition of "first home buyer". The eligibility criteria for the housing withdrawal and housing deposit subsidy are shown in the table below.

Eligibility criteria for *KiwiSaver* home ownership assistance

Eligibility criteria	**Housing withdrawal**	**Housing deposit subsidy**
Once only	√	√
First home	√	√
Three year requirement	√ (participation)	√ (contribution)
Primary place of residence	√	√
Minimum occupation period	NA	√ (period still to be determined)
Withdrawal of funds (excludes $1000 government contribution)	√	NA
Household income cap	NA	√ (caps still to be determined)
Regional house price cap	NA	√ (caps still to be determined)
Repayment possible (suspensory loan)	NA	√

37. Housing New Zealand Corporation (HNZC) has the legislative authority to administer suspensory loans. Hence, the housing deposit subsidy can be implemented outside of the KiwiSaver package.

First Home Buyers

38. In reference to the housing deposit subsidy, “first home buyers” are defined as KiwiSaver “participants who have never owned a home or had an interest in a home” [CAB Min (05)13/10 paragraph 2.2 refers]. Officials consider that the definition of “first home buyers” should be the same for both housing deposit subsidy and housing withdrawal applicants.

39. Cabinet requested further work on the implications for sole parents of restricting the housing deposit subsidy to first home buyers only [CAB Min (05) 13/10 paragraph 20 refers]. We also note that any change may also have similar impacts for the housing withdrawal.

40. Restricting eligibility to first home buyers explicitly excludes people who have, in the past, part-owned a home but no longer have a share in the property, for example due to the dissolution of a relationship or other adverse circumstances (i.e. “second chance” buyers). Officials consider that the housing deposit subsidy eligibility criteria could be broadened to include “second chance” buyers, including sole parents. Administrative rules would need to identify the appropriate “second chance” buyer cases while minimising the risk of gaming. Officials will continue to consider this issue, including the likely impact on take-up and costs, and report back in due course.

Primary Place of Residence

41. A requirement for the housing deposit subsidy is that recipients use the housing deposit subsidy to buy a house as their “primary place of residence”. Officials seek to confirm with you that this requirement should also apply to funds accessed through the housing withdrawal.

42. Officials current thinking is that “primary place of residence” should include land purchased with the clear intention of building a first home. It should also include shares in land or housing that carries a right of use or occupation within a reasonable period. For example, primary place of residence could be defined as “the dwelling house or, as the case may be, the residential land, that is to be occupied by the person to whom the land or shares is conveyed primarily and principally for residential purposes for that person and any members of that person’s family”. This was the definition used for stamp duty purposes in relation to the first home exemption from conveyance duty.

43. The housing deposit subsidy will be delivered in the form of a suspensory loan that would be repaid if the property were no longer (or never was) their primary place of residence. Officials have proposed exceptions-based reporting for monitoring compliance i.e. the government would not actively monitor but would reserve its right to enforce repayment if it came to HNZC’s attention that someone had fraudulently received the housing deposit subsidy.

44. Officials will carry out further work on the minimum reasonable period of occupation, justified exceptions, the approach to monitoring compliance and whether or not penalties can be imposed as well as requiring repayment.

Three Year Requirement

45. KiwiSaver participants are eligible for the housing withdrawal and housing deposit subsidy after three years [CAB Min (05) 13/10 paragraph 9.1 refers]. The Cabinet paper mentions “three years of participation” for the housing withdrawal and “three years of contribution” for the housing deposit subsidy.

46. Making the participation and contribution tests the same for both the housing withdrawal and housing deposit subsidy would be administratively simple for applicants and the administering agency, particularly if a large proportion of savers who are first home buyers will be eligible for both.

47. The housing withdrawal allows KiwiSavers to access their own funds while the housing deposit subsidy provides a government contribution. Hence, there may be a case for a stricter test for the housing deposit subsidy (based on contributions over three years) than the withdrawal (having an account open for three years). In practice, it is likely that many applicants will access both forms of assistance at the same time, i.e. when they buy their first home.

48. Further work is required before the contribution test can be set, including how to deal with periods of non-continuous contributions and self-employed members.

Verifying that an Individual has Met the Participation Test for the Housing Withdrawal

49. Verification would be required to confirm that an applicant has participated for three years. There are four main options for a starting date:

- the date the first deduction is made by the employer;
- when the first contribution is received by Inland Revenue;
- the date the first contribution is sent to a provider; or
- an arbitrary date in the month of the first deduction.

50. Officials consider that using the date of the first deduction by the employer is likely to create compliance costs for employers since they do not provide this information currently.

51. Using the date of receipt of first contribution by Inland Revenue will still mean there is a discrepancy between the time the deduction is made and the time the contribution is received by Inland Revenue. However, it is likely to be less significant and dependent on an employer's PAYE payment date and when deductions were first made by the employer.

52. If the date the first contribution is sent to a provider (eight weeks after being received by Inland Revenue) is used as the start date, it is likely to disadvantage savers who have opted-in or made the decision to stay in the scheme from day one. This approach effectively extends the participation period by as much as approximately four months after the first contribution was deducted from the member's pay by the employer.

53. Another alternative is to use the date used for calculation of interest (15th of the month in which the deduction was made). Using this approach would be consistent with the calculation of interest (nominal date that contribution was received), is more equitable to the contributor and still deals with the compliance costs issues.

54. On balance, officials recommend using the 15th of the month in which the first deductions were first made as the start date for participation.

55. A question yet to be answered is who should hold the information needed to determine whether a person is eligible for the housing withdrawal: the central administrator; another agency, such as HNZC; or the providers. Any option would impose some compliance costs on providers. However, as the trustee will necessarily be involved in the housing withdrawal process, requiring the trustee to administer the withdrawal and keep information will create a more seamless and administratively simple process. Officials wish to test this option through consultation with providers as well as ensure

that this information will be available to HNZC when it determines whether an individual is eligible for the deposit subsidy (i.e. where a previous housing withdrawal makes an individual ineligible for the subsidy).

56. For members with an RSS eligible for the housing withdrawal, the three year period would start on 1 April 2007 and the date the member first started contributing to their RSS, whichever is the latter.

Administering the Housing Withdrawal and Housing Deposit Subsidy

57. The Cabinet paper on the home ownership package noted that the administration costs of a housing deposit subsidy are expected to be appropriated in Vote Housing [CAB Min (05) 13/10 refers].

58. Savers would apply to the trustee for the housing withdrawal, while HNZC would administer the housing deposit subsidy. As part of further work on the operational details, officials will consider ways to streamline the process for people seeking both the housing withdrawal and the housing deposit subsidy, such as whether HNZC could act as a front-office that collects both applications and passes the housing withdrawal one on to the trustee.

59. Officials will continue to identify what information needs to be shared between agencies and providers, any privacy issues and tax secrecy implications as well as the best way to maintain records of housing withdrawals and housing deposit subsidies.

60. Officials consider that the housing withdrawal and housing deposit subsidy should be paid to the solicitor once the sale and purchase contract becomes unconditional. This ensures that the housing withdrawal and housing deposit subsidy can only be used for the purchase of a home and minimises problems of recovering a housing deposit subsidy or housing withdrawal if a sale does not proceed. This is currently the approach used by Kiwibank when making advances through the Mortgage Insurance Scheme. Officials wish to test this with the New Zealand Law Society and the New Zealand Real Estate Institute.

Fund Withdrawal Tax

61. Fund withdrawal tax (FWT) was a legislative measure that was introduced on 1 April 2000 to counter avoidance of the top personal tax rate of 39% through the use of employer contributions to superannuation funds. FWT is a 5% tax which applies to certain withdrawals from superannuation funds.

62. KiwiSaver schemes will be required to allow a housing withdrawal for KiwiSaver participants who are first home buyers. Without legislative provision to the contrary, withdrawal of any employer contributions that have vested in the employee would be subject to FWT. The FWT legislation already provides certain exceptions from FWT. Officials recommend an amendment to the Income Tax Act, providing an exclusion from the FWT rules where the housing withdrawal consists of vested employer contributions that form part of an approved KiwiSaver withdrawal for a first home. A similar amendment would be needed for housing withdrawals from a KiwiSaver "converted" section of an RSS, if permitted.