Ministry of Economic Development
Manatū Ōhanga
Insurance and Superannuation Unit

LEGISLATION CHANGES AFFECTING SUPERANNUATION AND RELEVANT CASE LAW:
covering the period from 1 July 2005 to 30 June 2007

1 LEGISLATION

1.1 Superannuation Schemes Act 1989

The Superannuation Schemes Act 1989 provides for the registration of superannuation schemes and governs all registered schemes. There is a summary of the Act and all amendments made to it since 1989 on the website under the heading 'history of legislative changes made to the Superannuation Schemes Act 1989'.

1.2 Superannuation Schemes (Fees) Regulations 1992

The fees payable to the Government Actuary under the Superannuation Schemes Act 1989 remain at the levels which came into force effective 1 January 2002 under the Superannuation Schemes (Fees) Amendment Regulations 2001. As from 1 December 2006, Item 1A of Part 1 of the Regulations was inserted by regulation 4 of the Superannuation Schemes (Fees) Amendment Regulations 2006. Item 1A details a fee payable for an application for approval of a transfer under section 9BAA of the Superannuation Schemes Act 1989, being $100 per half hour of time spent by the Government Actuary in considering the application.

1.3 New Zealand Superannuation and Retirement Income Act 2001

New Zealand Superannuation and Retirement Income Amendment Act 2006

This Act came into force on 1 July 2006 and amended various sections of the New Zealand Superannuation and Retirement Income Act 2001. The amendments:

- remove one of the excluding factors for determining eligibility for living alone payments;
- refine the scope of the test for determining whether or not the spouse of a person in long term residential care is entitled to a benefit; and
- extend the period during which persons otherwise entitled to receive New Zealand superannuation may be absent from New Zealand on humanitarian work and still be paid a benefit, with consequential amendments to section headings.

Social Security Amendment Act 2007 (No 20)

The Social Security Amendment Act 2007 received royal assent on 23 June 2007. Section 12 made the following amendments, which came into force on 2 July.

Section 12(1) inserted section 80AA of the Social Security Act 1964, allowing the Minister to consent to payments of benefits being back-dated where there was an earlier failure to grant it based on error.

Section 12(2) consequentially amended sections 11, 14 and 28 of the New Zealand Superannuation and Retirement Income Act 2001. The amendments make the provisions relating to the commencement dates of New Zealand superannuation, living alone payments, and payment overseas of New Zealand superannuation subject to section 80AA.

1.4 **Government Superannuation Fund Amendment Act (No 3) 2005**

This Act amended, with effect from 1 July 2006, both the 1969 and 1990 Government Superannuation Fund Amendment Acts. The 1969 Act has had the required amount of contributions to the GSF amended, and the percentage of each annual adjustment amended. The heading to section 8 of the Government Superannuation Fund Amendment Act 1990 relating to pensions payable to a surviving spouse or partner has been amended to better reflect the content of the section.

1.5 **Securities Act (Employee Share Purchase Schemes – Listed Companies) Exemption Notice 2006**

This notice replaced the Securities Act (Employee Share Purchase Schemes) Exemption Notice 2002 which has been revoked. This notice largely reproduces the provisions of the old notice in relation to listed companies. Substantive changes include the addition of an exemption from clause 1(3) and (4) of Schedule 1 of the Securities Regulations 1983. This exempts certain requirements in relation to registered prospectuses for equity securities. The conditions restricting the persons to whom allotments can be made have been refined.

The new notice took effect from 10 February 2006 and expires on 28 February 2011.

1.6 **Securities Act (Financial Institutions) Exemption Notice 2006**

This notice is virtually identical to the Securities Act (Financial Institutions) Exemption Notice 2001 which expired on 28 February 2006, and allows financial institutions to use financial statements and related information in prospectuses that comply with relevant financial reporting standards, rather than information under the Securities Regulations, in relation to debt securities. The changes from that notice are:

- Previously, compliance with Financial Reporting Standard No 33 (Disclosure of Information by Financial Institutions) approved in April 1997 (“FRS-33”) was one of the conditions of the exemption. The alternative of compliance with the New Zealand equivalent to International Accounting Standard 30 (Disclosures in the Financial Statements of Banks and Similar Financial Institutions) (“NZ IAS 30”) has now been added;
- The addition of a number of new definitions to accommodate NZ IAS 30 compliance;
- Minor drafting revisions and corrections.

The new notice took effect from 9 June 2006 and expires on 30 November 2008.

1.7 **<u>Securities Act (Unit Trust Short Form Prospectus) Exemption Notice 2006</u>**

The Securities Act (Unit Trust Short Form Prospectus) Notice 2002 expired on 27 April 2006. The old notice exempted every manager of a unit trust, subject to certain conditions, from regulation 3(4) of the Securities Regulations 1983 in respect of offers of units to persons who were already holders of units in the same unit trust. The effect of the 2002 notice was to allow a short form prospectus to be registered in relation to an offer of units to current unit holders. Similar provisions apply to an offer of equity or debt securities (see regulation 4 of the Securities Regulations 1983). The 2002 notice also gave an exemption from section 37A(1)(a) of the Securities Act 1978 (the investment statement requirement) for managers of unit trusts in respect of the allotment of securities to persons who have had an offer of securities renounced in their favour.

The new notice carries forward the effect of the 2002 notice with effect from 12 May 2006, with no changes of substance, and expires on 31 May 2011.

1.8 **<u>Securities Act (Superannuation Schemes – Summary of Financial Statements) Exemption Notice 2006</u>**

The Securities Act (Superannuation Schemes – Summary of Financial Statements) Exemption Notice 2006 came into force on 25 August 2006. The exemption notice provides an exemption from the requirement, under schedule 3C of the Securities Regulations, to distinguish between realised and unrealised gains or losses on investments in the summary of financial statements in a superannuation scheme prospectus.

The exemption is granted on the condition that the summary of financial statements contains the aggregate change in the value of investments, and such amounts must be the amounts which appear in financial statements which comply with Financial Reporting Standard No 32 or New Zealand Equivalent to International Accounting Standard 26.

The exemption notice replaces the 1998 notice, which expired on 30 June 2006. The new notice provides the same relief, but has been updated to also refer to the New Zealand equivalent to International Accounting Standards.

1.9 **<u>Taxation (Savings Investments and Miscellaneous Provisions) Act 2006</u>**

The Taxation (Savings Investments and Miscellaneous Provisions) Act 2006 came into force on 18 December 2006. It introduced a number of changes relevant to the taxation of interests in superannuation schemes and other collective investment schemes.

Of specific relevance to superannuation schemes are the amendments to the provisions relating to specified superannuation contribution withholding tax. Two fundamental changes were introduced with effect from 18 December 2006:

- Sections NE 2AA and NE 2AB of the Income Tax Act 2004 relating to the former progressive rates of specified superannuation contribution withholding tax have been repealed. In their place is a new section NE 2B which allows an employer making specified superannuation contributions on behalf of an employee to choose a specified superannuation contribution withholding tax rate based upon

revised threshold income levels of the employer concerned. These changes reflect the Government measures to counter what has been called "extreme salary sacrifice".

- KiwiSaver-equivalent relief from the obligation to withhold tax from specified superannuation contributions made by an employer on behalf of an employee has been provided, where those contributions are made that are subject to complying fund rules, through introduction of a new section NE 3B of the Income Tax Act 2004. In effect, specified superannuation contributions of up to 4% of the relevant employees total salary or wages are exempt from SSCWT, provided those contributions are matched by an equivalent contribution from the employee.

For collective investment schemes in general, new investment tax rules were introduced. Under those rules, superannuation schemes that satisfy certain eligibility criteria are able to elect, with effect from 1 October 2007 or such later date as may be elected, to become a portfolio investment entity ("PIE"). This allows (amongst other things) for a flow through tax treatment of income for members, with all taxable income less deductible expenses and tax credits related to the scheme's investments allocated to members on a proportionate basis, and with tax payable on those allocations at each member's "prescribed investor rate". For any member in a superannuation scheme this will be either 0% (for members who themselves are registered superannuation schemes), or 19.5% or 33% (reducing to 30% from 1 April 2008) in respect of any individual member, with individual member rates determined by reference to levels of income (including allocations of portfolio investment entity income) in either of the two preceding tax years. In addition, for schemes that elect into the PIE regime, there is relief from capital gains on investments made in certain Australasian shares and certain Australian unit trusts.

In addition to the introduction of the PIE regime, this Act introduced the fair dividend rate ("FDR") method of calculating the level of taxable income generated from holdings in certain off shore investments, in general terms being holdings that fall outside of the capital gains tax relief available to portfolio investment entities, and that do not have certain debt security characteristics. The FDR regime came into effect from 1 April 2007, although for some superannuation schemes its implementation has been deferred, depending up variables such as scheme balance dates and election options.

The changes to the taxation of investments made by superannuation schemes as introduced under the Act are complex, with a number of details and exceptions not covered by the above general summary.

Trustee Act 1956

The Taxation (Savings Investments and Miscellaneous Provisions) Act 2006 also introduced a new section 42E to the Trustee Act 1956. That provision allows (amongst other things) the trustees of any superannuation scheme that is a portfolio investment entity the ability to adjust the interests of those beneficiaries to reflect the effect of their portfolio investor rates, despite any other provision in the Superannuation Schemes Act 1989 or in the scheme's governing trust deed.

1.10 The Taxation (KiwiSaver and Company Tax Amendments) Act 2007

The Taxation (KiwiSaver and Company Tax Amendments) Act 2007 was passed under urgency after the May 2007 budget, and received Royal assent on 21 May 2007. This Act introduced amongst other things, the concept of member tax credits to become available in relation to contributions to KiwiSaver schemes and to complying superannuation funds, in relation to contributions made on or after 1 July 2007.

In addition, the Act reduced the top prescribed investor rate in relation to investments into superannuation schemes that are portfolio investment entities to 30%, instead of the previous 33%, with effect from 1 April 2008. At the same time, the tax rate for widely held superannuation funds that are not portfolio investment entities was reduced to 30% with effect from 1 April 2008. These changes in tax rates are in line with the reduction in tax rates payable by companies.

The Act also introduced a number of technical changes of relevance to superannuation schemes that elect to become portfolio investment entities.

1.11 International Financial Reporting Standards

Compliance with New Zealand International Financial Reporting Standards became mandatory for superannuation schemes in respect of any financial year commencing on or after 1 January 2007. Amongst other things, this may require classifying members' equity in superannuation schemes as financial liabilities. In effect member balances that would make up the benefit payable to them are required for financial reporting purposes to be treated as financial liabilities of the scheme. In addition, schemes may need to restate their most recent financial statements (i.e. for the financial year commencing in 2006) under New Zealand International Financial Reporting Standards for comparative financial reporting purposes,

2 CASE LAW

2.1 Recent New Zealand Decisions

Perpetual Investment Management Limited **(2006) 9 NZCLC 264, 207**

Perpetual is an Australian based fund manager and offered interests in Australian unit trusts to the New Zealand public under the terms of the Securities Act (Australian Registered Managed Investment Schemes) Exemption Notice 1999 ("the Exemption Notice").

Perpetual failed to file certain documents with the Companies Office within the tight timeframes required by the Exemption Notice. As a consequence, void allotments arose and Perpetual was required to repay subscriptions, plus interest at 10%, to 375 investors.

Perpetual applied to the High Court for relief from the obligation to repay investors under the relief provisions introduced into the Securities Act in 2004. Perpetual notified all investors of its application for a relief order. 374 of those investors did not object, meaning that it was mandatory for the Court to grant relief orders relating to their investments.

One investor objected to the relief order being made. The Court had a discretion to grant relief in relation to that investor and, in deciding whether to do so, was required to

have regard to whether the contravention materially prejudiced the investor. The judge observed:

> *"The Court must be mindful of the purpose of the legislation. If there are purely technical breaches such as late filing of documents and no cogent reasons given by an objector as to how his or her interests have been "materially prejudiced" by such technical contravention, then it is obvious that the purpose of the legislation was to ensure that relief be granted."*

The Court held that the failure to file documents with the Companies Office was a technical breach and that it did not materially prejudice the investor. Accordingly, the Court granted the relief order sought.

Whilst registered superannuation schemes do not offer interests in reliance upon the Exemption Notice, the relief provisions under the Securities Act where void allotments have occurred are of general application. The Perpetual decision is relevant to superannuation schemes that may have offered membership in breach of the technical filing requirements of the Securities Act.

Manning & 29 Ors v Hewlett Packard NZ LTD **13 June 2007, R Arthur, AA 175/07**

In this Employment Relations Authority decision, an order was made removing the matter to the Employment Court under section 178(2)(a) of the Employment Relations Act.

The 30 applicants were members of the Hewlett Packard (New Zealand) Limited Retirement Plan, an employee superannuation scheme. The respondent stopped paying superannuation contributions to the applicants without providing them with any compensation for loss of the contributions. The dispute centred on the process for change and closure of an employee superannuation scheme.

The case in the Employment Court will address "what amounts to a condition, the extent of obligations under such conditions and the ability to change those conditions". Those questions are of heightened interest and importance to both employers and employees looking at changes to their existing superannuation scheme arrangements with the introduction of KiwiSaver and the possibility of compulsory employer contributions to KiwiSaver schemes from1 April 2008.

The *Dark v Weenink* decisions

These three decisions of the High Court serve as a useful practical example of the circumstances in which trustees should consider seeking directions from the Court or at least the circumstances in which they should not rely solely upon legal advice obtained by an interested employer.

Dark v Weenink [2005] BCL 810

This decision involved a claim against the trustees of an employment superannuation scheme by the widow of scheme member Mr Dark.

The Court considered whether the circumstances in which Mr Dark died, owing money to the Company, prejudiced his death benefit. The decision confirmed that the trust

deed provision at the centre of proceedings, involving forfeiture in circumstances where a member who was either dismissed from service or had left service to avoid dismissal on the grounds he owed money to the company, did not operate so as to override the death benefit. Further, the Court indicated that had it been relevant it would have been prepared to grant relief against forfeiture to the extent that operation of the defalcation clause would have reduced the benefit payable by more than the amount of the loss.

However, the Court dismissed Mrs Dark's claim, on the basis that she was only a potential beneficiary and the trustees needed to exercise their discretion to decide upon the recipient of the death benefit, before she could take things any further.

Dark v Weenink 5/2/07, Winklemann J, HC Auckland

The February decision related to a claim by Mrs Dark for her costs to be met out of the scheme. The trustees took the line that costs should lie where they fall, on the basis that Mrs Dark did not succeed in her pleaded causes of action. They argued that as they were successful on all causes of action, the fair outcome was for each party to meet their own costs.

The Court disagreed. The essential issues before the Court in 2005 were whether the forfeiture provision in the trust deed applied to death benefits. If it did, had Mr Dark been dismissed on the specified grounds, or had he left to avoid such dismissal. If not, the death benefit provision would come into play.

The February 2007 decision confirmed that the above issues could all have been the subject of an application for directions by the trustees. Whilst Mrs Dark's original claim had been unsuccessful in that the trustees were not required to exercise a discretion in her favour, she had successfully challenged the trustees' interpretation of the forfeiture provision. She had also successfully challenged the company's assertion that Mr Dark had been dismissed on specified grounds or left service in order to avoid such dismissal.

The trustees' argument that the situation should be treated as a hostile claim contrary to the interests of the scheme was rejected. If Mrs Dark had not brought the proceedings, then the forfeiture of the death benefit would have stood, meaning Mrs Dark was a necessary party to the proceedings and acted reasonably in bringing them.

The quantum of costs for which Mrs Dark was entitled to be indemnified was finally resolved in *Dark v Weenink (No 2)* 16/4/07, Winklemann J, HC Auckland

2.2 **Significant Overseas Decisions**

Steria Ltd and ors v Hutchison and ors [2006] EWCA 1551 and *Hodgson v Toray Textiles Europe Limited* [2006] EWHC 2612 (Ch)

Steria Ltd and Ors v Hutchison and Ors and *Hodgson v Toray Textiles Europe Ltd* are two recent British cases regarding pension schemes. They may have implications for the situation where informal documentation is at odds with formal trust deeds and scheme rules.

In both cases representations made in supporting documents were at odds with the information contained in the formal trust deeds. The supporting documents contained a statement to the effect that in any question of interpretation the trust deed and rules prevailed over the booklet.

Both cases gave rise to various claims of estoppel, as claimants contended that the informal documents conveyed a false impression of the benefits available under the scheme which they then relied on. In both instances it was found to be an insurmountable hurdle that the booklets in question contained statements that they were subject to the terms and conditions of the formal documents. Accordingly, claimants could not reasonably be held to have relied on the representations in the booklet.

In each Court's view, a decision to the contrary would mean a booklet of that kind would override the rules, when the booklet itself clearly says this is not the case.

These cases are a reminder of the importance of including statements to the effect that the relevant trust deed will prevail over conflicting terms in supporting documents. Given fair trading and employment law implications, however, the decisions do not detract from the importance of trustees ensuring that any documentation produced in support of a scheme is not at odds with the terms of the governing trust deed.