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WEEKLY COMMENT: FRIDAY 21 JUNE 2013

1. The *Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Bill* ("the Bill") was introduced on 20 May 2013. Week-before-last week I looked at the inclusions and exclusions in the new foreign superannuation withdrawals rules, which will apply from 1 April 2014. Last week I looked at the meaning of assessable period and the formula method. This week I look at the schedule method.

2. As noted last week, the assessability of the withdrawal will depend on identifying the correct *assessable period*, which is the period during which a withdrawal will be taxable income. The rules for identifying the correct assessable period were covered last week. This week I look at how the schedule method is used to determine the *part* of a foreign superannuation withdrawal that is not exempt from income tax (the "assessable withdrawal amount").

3. The topics covered this week are:

   (a) The schedule method; and

   (b) KiwiSaver withdrawals to fund the tax liability.

4. Taxpayers will not be able to switch from the schedule method to the formula method.

The schedule method

5. The schedule method is the default method for taxing foreign superannuation withdrawals, and must be used to calculate a person's assessable withdrawal amount if:

   (a) The person cannot use the formula method; or

   (b) The person chooses not to use the formula method.

6. The schedule method deems a certain amount of the lump-sum receipt to be investment gains, based on the person's years of residence. The approach uses fractions that represent the proportion of the lump-sum receipt to be included in assessable income. The schedule year fractions increase with years of residence. The remainder of the lump-sum receipt is not assessable.

7. The assessable withdrawal amount under the schedule method is calculated using the formula:

$$(\textbf{super withdrawal - contributions left}) \textbf{ x schedule year fraction}$$

   Super withdrawal: Is the amount of the foreign superannuation withdrawal;

Contributions left: Is the lesser of:

(a) The amount of the super withdrawal; and

(b) The total **recognised contributions** under s. CF 3(16) – see paragraph 10 of last week's *Weekly Comment* - made in the assessable period before the distribution time, reduced, for each earlier foreign superannuation withdrawal made in the assessable period before the distribution time, by the lesser of:

  (i) The amount of the earlier withdrawal; and

  (ii) The value of the item contributions left, immediately before the time of the earlier withdrawal.

Schedule year fraction: Is the fraction given in schedule 33, column 2 of the row for which the entry in column 1 corresponds to the greater of 1 and the number of income years beginning:

(a) In an *assessable period* for the person under s. CF 3(5); and

(b) After the time when the person acquires the interest; and

(c) Before the distribution time when the person derives the foreign superannuation withdrawal.

8. The "contributions left" item in the formula must meet the requirements as set out in paragraph 10 of last week's *Weekly Comment*. It is noted on page 13 of the *Commentary* that:

   "The contributions that are able to be deducted are restricted in this manner because the schedule rates already include an implicit allowance for contributions. For example, for the year one schedule rate, 4.76% of the withdrawal is treated as taxable New Zealand-sourced gains and the remainder is treated as non-taxable amounts (that is, contributions as well as gains derived while non-resident)."

9. With respect to the schedule year fraction. it is stated on page 10 of the *Commentary* that:

   "The fractions in proposed schedule 33 are set at the rate necessary to put a person who leaves their foreign superannuation overseas in the same position as if they had instead transferred their superannuation to New Zealand and paid tax on investment gains as they accrued. Given the assumptions (including a 5% post-tax interest rate in the foreign scheme), a person should conceptually be indifferent between keeping their superannuation overseas and transferring it to New Zealand. Further discussion of the policy rationale behind the schedule method can be found in the annex to the issues paper. …

   The appropriate "schedule year fraction" to use is identified by calculating the number of income years beginning in the assessable period, before the person receives the lump sum. In short, *this is the number of income years which begin after the person is a New Zealand resident and after their four-year "exemption period" ends*. The effect of counting a person's years of residence from the end of the exemption period is to treat them as being non-resident during the exemption period. Gains which accrue during those four years will not be clawed back and taxed on receipt." (emphasis added)

10. For example:

   (a) If Lucy's assessable period begins on 1 August 2020, and she withdraws a lump sum on 27 January 2024, there are *three income years* that begin in Lucy's assessable period, the

first one starting from 1 April 2021 so Lucy is required to use the schedule year fraction for year three.

(b) If the withdrawal is made in the first part year after the person's exemption has ended, so that the number of income years beginning in the person's assessable period is zero, the person should use the schedule year fraction associated with year one. For example, if Karen's assessable period begins on 1 October 2020, and she withdraws a lump sum of on 5 February 2021, Karen is required to use the schedule year fraction for year one because the withdrawal was made between 1 October 2020 and 31 March 2022.

11. Proposed new schedule 33 provides the full schedule of rates per year of residence.

12. *Let's follow the Example on page 15 of the Commentary as we did last week for the formula method*: Thomas migrates to New Zealand with a foreign superannuation scheme worth NZ$100,000. Ten years after Thomas' assessable period begins, his scheme is worth $180,000 and he withdraws a lump-sum amount of $60,000. Five years after this, his scheme is worth $150,000 and he withdraws the full amount. Thomas has made no contributions to the scheme while he has been New Zealand-resident.

13. For Thomas' first withdrawal, the schedule year fraction for year 10 is 44.39%. Therefore, Thomas' assessable withdrawal amount under the schedule method will be $26,634. This compares with $31,458.66 under the formula method, as calculated in paragraph 16 of last week's *Weekly Comment*.

14. For Thomas' second withdrawal, the schedule year fraction for year 15 is 64.08%. Therefore, Thomas' assessable withdrawal amount under the schedule method will be $96,120. This compares with $102,852.42 under the formula method, as calculated in paragraph 16 of last week's *Weekly Comment*.

15. In this case, the schedule method provides better answers for both withdrawals. A comparison between methods will need to be made for the first withdrawal. Remember that taxpayers will not be able to switch from the schedule method to the formula method.

KiwiSaver withdrawals to meet the tax liability

16. Where a foreign superannuation withdrawal has been converted into an interest in a KiwiSaver scheme, new Schedule 1, cl.14A of the *KiwiSaver Act 2006* provides that a member may apply for a withdrawal from a KiwiSaver scheme to meet the tax liability (other than interest or penalties) to:

(a) The trustees (in the case of a restricted KiwiSaver scheme); or

(b) The manager (in the case of any other KiwiSaver scheme).

17. The amount withdrawn cannot exceed the lesser of:

(a) The member's liability for tax:

(b) The value of the member's accumulation less the amount of the Crown contribution.

18. An application under cl. 14A(1) must:

(a) Be made by the member:

(i) Before 1 April 2016, if the member's foreign superannuation withdrawal is derived before 1 April 2014; or

    (ii) Within 24 months of the member's foreign superannuation withdrawal, if the withdrawal is derived on or after 1 April 2014; and

(b) Be in the form required by the trustees or manager (as the case may be); and

(c) Must include a completed statutory declaration giving the relevant details of the foreign superannuation withdrawal, the reinvestment, and the resulting liability of the member for tax under the *Income Tax Act 2007*; and

(d) Must include any documents and other information that may be required by the trustees or manager (as the case may be) in support of the statutory declaration.

19. The manager of the KiwiSaver scheme must be sufficiently satisfied that the requested amount does not exceed what a hypothetical tax liability could be for that person in relation to that interest. The money will be paid to the individual rather than directly to Inland Revenue, so the individual will be responsible for ensuring that their tax liability is paid.

Detailed PDF attachment on the new rules

20. The PDF attachment *Withdrawals From Foreign Superannuation Schemes* contains all of the details.

Arun David, Director

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