



## WEEKLY COMMENT: FRIDAY 3 JANUARY 2014

1. The *Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Bill* ("the Bill") was reported from the Finance and Expenditure Committee on 28 November 2013. This week and in the two weeks following I look at the new foreign superannuation withdrawals rules with a focus on the changes from the rules contained in the Bill when it was introduced on 20 May 2013. The start date for the new rules is unchanged and remains 1 April 2014.
2. This week, I look at the inclusions and exclusions. Next week I will look at the circumstances in which the FIF rules can continue to apply, the KiwiSaver withdrawal mechanism to fund tax liabilities and the reduced-rate temporary amnesty for pre-1 April 2014 withdrawals. Week-after-next I will look at the new methods for calculating taxable income.
3. The topics covered this week are:
  - (a) Benefits that the new rules will apply to;
  - (b) Foreign superannuation scheme inclusions and exclusions;
  - (c) Pensions and annuities exclusion;
  - (d) Requirement that the interest was acquired when the person was a non-resident;
  - (e) Initial period of residency exemption;
  - (f) Australian superannuation scheme withdrawal exemption;
  - (g) Exemption for transfers between two foreign (non-Australian) superannuation schemes;
  - (h) Exemption for purchase of a foreign annuity;
  - (i) Exemption for spousal transfers upon death or cessation of a relationship;
  - (j) Clarification that ceasing to be a NZ resident will not trigger a taxing event.

### **Benefits that the new rules will apply to**

4. Under the new rules, taxable income will arise under the general rules, and the FIF rules will not apply, when a person who is a New Zealand resident derives a benefit (a *foreign superannuation withdrawal*) that:
  - (a) Is not a pension or annuity; and
  - (b) Arises from an interest, other than a *FIF superannuation interest*, in a *foreign superannuation scheme*, that the person acquires:
    - (i) When the person is a non-resident; or

- (ii) By way of a transfer from a former foreign (non-Australian) superannuation scheme;  
or
  - (iii) From a spouse as a result of death or under a relationship agreement; and
- (c) Is in the form of:
- (i) An amount derived by the person as a member or beneficiary of the scheme; or
  - (ii) An interest of the person in the scheme, withdrawn for reinvestment as an interest of the person in a superannuation scheme in New Zealand; or
  - (iii) An interest of the person in the scheme, outside Australia, withdrawn for reinvestment as an interest of the person in a superannuation scheme in Australia;  
or
  - (iv) An interest of the person in the scheme (anywhere in the world) withdrawn, for reinvestment as an interest of another person in a superannuation scheme (subject to rollover relief – discussed from paragraph 30 onwards below - when the other person is the spouse of the person, and the transfer occurs upon the death of the person or under a relationship agreement because the relationship has ceased).
5. A benefit derived from a *FIF superannuation interest* will remain subject to the FIF rules and will be discussed further in next week's *Weekly Comment*.

### **Foreign superannuation scheme inclusions and exclusions**

6. A *foreign superannuation scheme* is a defined term in s. YA 1, and refers to a trust, unit trust, or non-resident company established to provide retirement benefits to beneficiaries or members who are natural persons, and includes other arrangements constituted under foreign laws for the purpose of providing retirement benefits to natural persons.
7. Under a proposed new amendment to the definition of a “superannuation scheme” in clause 103(51B), a foreign arrangement for providing retirement benefits that resemble New Zealand superannuation will be specifically excluded. This follows from officials’ concerns, expressed in pages 10-11 of the *Officials’ Report to the Finance and Expenditure Committee on Submissions on the Bill* (the “Officials’ Report”), that the definition of a foreign superannuation scheme should not include overseas social security schemes. Both pensions and lump sums paid from overseas security schemes will be subject to tax under the ordinary tax rules.
8. A submission noted that it is not clear what superannuation funds would be taxed under the new rules, and that the legislation should include a number of common United States superannuation products and retirement savings schemes. Officials responded that the existing definition of a foreign superannuation scheme is reasonably broad and would likely include the schemes the submitter mentioned. In addition, officials have undertaken to provide more specific clarification in a guidance document (Officials’ Report page 10).

### **Pensions and annuities exclusion**

9. Pensions and annuities are specifically excluded from the ambit of the new rules. A “pension” is defined in s. CF 1(2), but an annuity is not defined. These are already subject to tax under the ordinary tax rules (and not under the FIF rules). Under s. EX 43, the rights of a natural person to benefit from a pension or an annuity provided by a FIF are not an attributing interest if:

- (a) The rights were acquired when the person was a non-resident or within 3 years of becoming a New Zealand resident, or in anticipation of becoming a non-resident; and
  - (b) The future benefits cannot be assigned or exchanged for cash or other property except under a relationship agreement, or at the cost of a substantial decrease in the present value of the benefits.
10. Officials declined a submission that the proposed treatment for lump sums should also apply to pensions (Officials' Report page 9).

**Requirement that the interest was acquired when the person was a non-resident**

11. A specific requirement under the changes proposed by the Finance and Expenditure Committee is that the interest in the foreign superannuation scheme should have been acquired when the person was a non-resident. This follows from officials' views (on pages 6-7 of the Officials' Report) that the receipts-based approach should be available only when the rights in the foreign superannuation scheme were first acquired when the person was a non-resident.
12. Where the person first acquired the rights in the foreign superannuation scheme while they were New Zealand resident, the FIF rules would apply.
13. Officials noted that under the receipts-based approach, if a person leaves New Zealand before receiving the lump sum they will not be subject to tax in New Zealand. Allowing the use of the receipts-based approach to New Zealand residents who invest in foreign funds could result in New Zealanders saving for their retirement using foreign superannuation schemes and then leaving New Zealand without being subject to tax on accrued gains.
14. Officials also noted that under current rules the FIF rules apply to rights acquired while a New Zealand resident, and other tax rules apply to rights acquired while a non-resident. Officials do not favour such an apportionment approach. Rather, officials consider that the receipts-based approach should be available only when the person first acquired the rights when they were non-resident.
15. In addition, the removal of the separate exemption period for transitional residents following the Finance and Expenditure Committee review (discussed in paragraphs 16 onwards below) serves to clarify that the exemption period for initial New Zealand tax residence will not be available for interests acquired after becoming a New Zealand tax resident.

**Initial period of residency exemption**

16. A foreign superannuation withdrawal will be exempt income of a person if it is derived during the period that the initial period of residency exemption in proposed s. CW 28B applies. The requirements for the initial period of residency exemption to apply to an interest in a scheme are as follows:
- (a) The person must not have enjoyed, before acquiring the interest, an exemption period for an interest in a foreign superannuation scheme; and
  - (b) The interest must have been acquired while the person was a non-resident; and
  - (c) The person must have owned the interest as a non-resident until the date the exemption commenced – which will be the date on which the person became a New Zealand resident.

17. The exemption will apply regardless of whether or not the person is a transitional resident. The separate transitional resident's exemption in the Bill as originally introduced has been removed. The exemption period has been exactly aligned with the period of transitional residence – i.e. from commencement (i.e. the date of becoming a NZ tax resident) until the end of 48 months after the month the person became a New Zealand tax resident. However the exemption ceases earlier if the person becomes a non-resident again and the date of non-residence is earlier.
18. The exemption will apply to migrants who arrived in New Zealand before 1 April 2014. In response to a submission that this point be clarified, the definition of “exemption commencement” now refers to “before or after commencement of the (amending) Act”.
19. The Bill as originally introduced provided for a later commencement date than the start of New Zealand residence if a person was non-resident under a tax treaty, and subsequently “tiebreaks” to New Zealand. Apparently this was to deal with circumstances such as where, for example, a New Zealand resident who went to the UK retained a house in NZ, became a UK resident under the NZ/UK tax treaty and then came back to New Zealand. However, officials now consider that NZ tax residence would not be retained in this type of scenario, so there is no need to cater for a “tiebreak” back to New Zealand (Officials Report pages 57-58).
20. Note that under proposed new s. CF 3(3), the exemption period will not be available for foreign superannuation interests that are acquired after the person becomes a New Zealand tax resident. This is regardless of whether or not the person is a transitional resident.

#### **Australian superannuation scheme withdrawal exemption**

21. Withdrawals from Australian superannuation schemes are not included as taxable benefits. It is stated on page 6 of the *Commentary* to the Bill that:

“Withdrawals from Australian schemes and transfers from Australian schemes to New Zealand schemes, are generally not taxed under the Australia-New Zealand double tax agreement or under the forthcoming trans-Tasman superannuation portability agreement (which took effect from 1 July 2013). This treatment will continue under the new rules.”
22. A lump sum withdrawal by a New Zealand resident from an Australian scheme will not be taxable in New Zealand under paragraph 2 of Article 18 of the double tax agreement between New Zealand and Australia, which states:

“Lump sums arising in a Contracting State and paid to a resident of the other Contracting State under a retirement benefit scheme, or in consequence of retirement, invalidity, disability or death, or by way of compensation for injuries, shall be taxable only in the first-mentioned State.”
23. A transfer from one Australian superannuation scheme to another Australian superannuation scheme is exempt income under s. CW 29.
24. Effective from 1 July 2013, when the retirement savings portability arrangements between NZ and Australia took effect, under s. CW 29B, an amount of income derived in an income year by a natural person from an Australian complying superannuation scheme is exempt income if, in the income year, it is contributed to a KiwiSaver scheme.

### **Exemption for transfers between two foreign (non-Australian) superannuation schemes**

25. Transfers between two foreign superannuation schemes will not constitute taxable withdrawals, providing that the transfer is not to an Australian superannuation scheme. The *Commentary* refers to this exemption as “rollover relief”. Instead, the person will be taxed on the eventual withdrawal or payment (or transfer to an Australian or New Zealand scheme) based on the length of their New Zealand residence from when they initially acquired the interest (in the first scheme).

26. This will be a change in the law. It stated on page 6 of the *Commentary* to the Bill that:

“A transfer between two foreign superannuation schemes typically gives rise to a taxable event under current law, being a disposal of rights in the first scheme and an acquisition of rights in the new scheme. ...

As transfers from Australian schemes are typically exempt, as noted above, transfers from a foreign scheme to an Australian scheme will be taxable as if the transfer was made to a New Zealand scheme.

**Example:** Sarah, a New Zealand resident, has an Individual Retirement Account in the United States. She wants to purchase an annuity with a different scheme provider. Under normal circumstances this would be taxable as it is a disposal and reacquisition. However, under the proposed new rules Sarah will get rollover relief so does not need to pay tax on the amount she withdraws to purchase the annuity. Any pension received while resident will be taxable under the current law.”

### **Exemption for purchase of a foreign annuity**

27. A submission was made that the legislation should also expressly provide that withdrawals/transfers/commutations to purchase an annuity from a foreign provider are not income.

28. Officials replied that under the proposed rules, the policy intention is that transfers from one foreign scheme to another foreign scheme will not be taxable. (This does not apply to transfers to Australian schemes, because subsequent withdrawals from Australian schemes are generally not taxable under New Zealand law).

29. The policy intention is that this would also apply where the transfer is made in order to purchase an annuity from another foreign superannuation scheme. Officials considered that the drafting is sufficiently clear on this point.

### **Exemption for spousal transfers upon death or cessation of a relationship**

30. The changes proposed by the Finance and Expenditure Committee include rollover relief for withdrawals and reinvestments upon death or relationship cessation: a foreign superannuation withdrawal is not income of the person if the benefit is an interest of the person in the scheme withdrawn:

(a) On the death of the person or under a relationship agreement arising from an event (the **relationship cessation**) that occurs when:

(i) For a marriage or civil union of the person, the marriage or civil union is dissolved or the person and the person's spouse or civil union partner separate or begin to live apart (whether or not they continue to live in the same residence);

- (ii) For a de facto relationship of the person, the de facto relationship ends; and
  - (b) For immediate reinvestment as an interest, in a foreign superannuation scheme outside Australia, of another person who is:
    - (i) A spouse, civil union partner, or de facto partner of the person immediately before the death or the relationship cessation; and
    - (ii) A New Zealand resident.
31. This represents a significant change from the rules as originally introduced. The rollover relief upon death has been restricted to surviving spouses and rollover relief for relationship termination has been included. Officials noted on page 14 of the Officials' Report that:
- "A transfer of a foreign superannuation interest from one person to another would generally constitute a taxable event. However, where the transfer occurs as a result of divorce, the end of a civil union, or the end of a de facto relationship and the transferee is a New Zealand resident, rollover relief would be provided. When a lump-sum withdrawal is ultimately made by the transferee, they would be taxed as though their assessable period had begun when their ex-partner's assessable period began.
- Officials also propose that where the transfer occurs upon the death of the transferor, rollover relief would be provided only where the transferee is a New Zealand resident and is the surviving spouse, civil union partner, or de factor partner. The assessable period would similarly be calculated from the beginning of the deceased's assessable period. Transfers to any other person should be taxed when the transferor dies."
32. The requirement that the transferee be a New Zealand resident arose out of a submission that under the previous drafting, the transfer of an interest from a New Zealand resident to a non-resident upon death would not be taxable. Officials responded that the original policy intention was that when an interest in a foreign superannuation scheme is transferred upon death from a New Zealand resident to a non-resident, the transfer would be taxable according to the deceased's assessable period. The previous drafting did not adequately reflect this policy intention and the provision has therefore been adjusted.

**Clarification that ceasing to be a NZ resident will not trigger a taxing event**

33. Submissions were made that the legislation should clarify that a person who ceases to be a resident of New Zealand does not automatically trigger a taxing event. Officials responded on page 54 of the Officials' Report as follows:
- "The proposed legislation has been drafted so that CF 3(1) identifies which particular events are considered to be taxable.
- It is implicit that the cessation of New Zealand residence is not a taxable event and no other part of the Income Tax Act 2007 would impose such an "exit tax". It is also implicit that transfers between non-Australian foreign superannuation schemes, or where the funds are used to purchase an annuity would not be taxable.
- Officials acknowledge that these submitters wish to improve the clarity of the proposed legislation, but consider that adding a specific provision to proposed CF 3 detailing events that are specifically *not* taxable would add unnecessary complexity to the proposed legislation. It could also create confusion as certain events may not appear in legislation as either taxable or non-taxable."

**Detailed PDF attachment on the new rules**

34. The PDF attachment *Withdrawals From Foreign Superannuation Schemes* contains the details on all of the changes proposed by the Finance and Expenditure Committee.



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