DavidCo Limited
CHARTERED ACCOUNTANTS

Level 2, Shortland Chambers
70 Shortland Street, Auckland
PO Box 2380, Shortland Street
Auckland 1140
T +64 9 921 6885
F +64 9 921 6889
M +64 21 639 710
E arun.david@davidco.co.nz
W www.davidco.co.nz

WEEKLY COMMENT: FRIDAY 10 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. The reported version contains a number of changes from the rules as originally introduced on 20 May 2013. However, the start date for the new rules is unchanged and remains 1 April 2014. Last week I looked at the types of withdrawals that are included in the new rules, and the exclusions that apply.

2. This week, I look at the circumstances in which the FIF rules will continue to apply, the 15% reduced rate amnesty for past non-compliance with the FIF rules and the relationship with the dividend rules and the trust rules. Over the next two weeks I will look at the assessable period and the calculation methods for calculating taxable income.

3. The topics covered this week are:

   (a) New FIF category: "FIF superannuation interests"

   (b) Ability to continue to use the FIF rules;

   (c) What does "treated as an attributing interest in a return of income" mean;

   (d) "Turning off" the FIF rules for non-compliance in the past;

   (e) Potential for double taxation of superannuation interest acquired when non-resident;

   (f) Foreign superannuation interest acquired by a NZ resident will remain a FIF;

   (g) Temporary reduced rate amnesty for pre-1 April 2014 lump sum withdrawals;

   (h) Consequent changes to the dividend and trust tax rules.

New FIF category: "FIF superannuation interests"

4. The second category of rights that constitute an attributing interest in a FIF in section EX 29(3) is being replaced. "Rights to benefit from a foreign superannuation scheme" is being removed and replaced by "a FIF superannuation interest". This is made clear by new s. EX 42B which states that a person's right to benefit from a foreign superannuation scheme as a beneficiary or member will not be an attributing interest in the foreign superannuation scheme if the right is not a *FIF superannuation interest* for the person. Consequently, a *FIF superannuation interest* will be the only type of attributing interest in a foreign superannuation scheme.

5. *FIF superannuation interest* is to be defined in s. YA 1 as meaning: for a person and an income year (the *current year*), an interest held by the person, in a foreign superannuation scheme as a beneficiary or member that:

   (a) The person acquires, or is treated as acquiring, when a resident of New Zealand other than:

      (i) From a person who acquired the interest when a non-resident; and

      (ii) By a transaction described in s, CF 3(18)(d) – i.e. by a transfer to a surviving spouse upon death, or a spouse upon the dissolution of a marriage; or

   (b) The person acquires, or is treated as acquiring, when a non-resident and that:

      (i) Is an attributing interest for an income year (the **qualifying year**) ending before 1 April 2014; and

      (ii) Is treated by the person as an attributing interest in a return of income for the qualifying year <u>filed before 20 May 2013</u> (the day on which the *Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Bill* was introduced); and

      (iii) Is held by the person for the period (the **qualifying period**) from the end of the qualifying year to the beginning of the current year; and

      (iv) Is treated by the person as an attributing interest in returns of income for the income years in the qualifying period.

Ability to continue to use the FIF rules

6. A person who has an interest in a foreign superannuation scheme cannot use the FIF rules unless the interest is a *FIF superannuation interest*, which meets the above-listed criteria. A person who has a *FIF superannuation interest* will have the option of either continuing to return income under the FIF rules (that is, their foreign superannuation interest will be "grandparented"), or applying the new rules instead.

7. If a person has two or more interests in foreign superannuation schemes, the criteria are assessed per interest (not just once for that person).

8. Importantly, an interest in a foreign superannuation scheme acquired when non-resident must have been treated as an attributing interest in a return of income filed before 20 May 2013. If that has not been done, the interest cannot be treated as a FIF interest. In a practical sense, this means that unless the interest was treated as an attributing interest in the 2012 income year (for taxpayers who have not filed their 2013 tax returns by 20 May 2013) it cannot be treated as an attributing interest in a FIF.

9. The definition requires continuous compliance with the FIF rules. The criteria must be met *each time* a person seeks to apply the FIF rules, i.e. every income year. If FIF income or loss is not returned in a year (in which the person still holds the interest), the interest will cease to be "grandparented" and will cease to be a FIF interest. In that case, the person must pay tax under the new rules on any subsequent withdrawal.

What does "treated as an attributing interest in a return of income" mean?

10. The Finance and Expenditure Committee noted that:

    "To ensure that taxpayers who have already complied with the FIF rules do not face higher compliance costs, the bill would permit them to continue using the FIF rules rather than

requiring them to comply with the new regime. However, the bill as introduced does not make it clear whether this would also apply where a taxpayer had earned no income, or incurred a loss, from the foreign investment fund, in which case no evidence of compliance would be recorded in their tax return.

We recommend amending the definition of FIF superannuation interest in clause 103(9) to make it clear that a taxpayer who had complied with the FIF rules in relation to a foreign superannuation interest, but had earned no income from the foreign investment fund, or incurred a loss, would remain free to use the FIF rules."

11. The definition of FIF superannuation interest has therefore been altered so as to remove the requirement that the interest "produced FIF income or loss". The example provided in the *Commentary* on the Bill is, therefore, no longer correct: that example required FIF income to be returned in the 2015 income year despite an exemption applying in order for the interest to remain grandparented.

12. Where a taxpayer has had no FIF income or loss, this would not be included in the person's tax return. It is not clear that they will be grandparented under the FIF rules, as the amount returned will be zero. Officials agreed that taxpayers in this situation should be able to continue using the FIF rules.

13. A submitter on the Bill noted that Inland Revenue may not be aware that a taxpayer has complied with the FIF rules because where there is a double tax agreement in force, a FIF disclosure form is not required. Officials replied that do not consider that any special rules are needed. The person must be able to show that they were subject to the FIF rules and complied with their obligations under the FIF rules, including correctly returning FIF income (if there was any) in respect of the FIF interest. *Officials will include a comment to this effect in a Tax Information Bulletin or similar guidance following enactment.*

"Turning off" the FIF rules for non-compliance in the past

14. Submitters on the Bill were concerned at the potential for double taxation if Inland Revenue pursues past non-compliance in the case of a person who did not comply with the FIF rules and is subject to the new rules on lump sums received after 1 April 2014.

15. Officials replied that the policy intention is that people who have not accounted for income under the FIF rules in previous years would be subject to the proposed new rules on any withdrawals made on or after 1 April 2014. It is not intended that these taxpayers would also be subject to audit activity on their unpaid FIF tax. The proposed rules for taxing lump sums would account for any tax that should have been paid on accrual, regardless of whether that tax was paid.

Potential for double taxation of superannuation interest acquired when non-resident

16. It follows from all of the above that if a person has returned FIF income in the past, but has failed to comply with the requirements for the interest to be a FIF superannuation interest in any income year, there will be double taxation. This is because the FIF rules would cease to apply, and withdrawals would be taxed under the ordinary rules.

17. Taxpayers who choose not to use the "grandparenting" option for their FIF superannuation interests run the same risk of potential double taxation.

Foreign superannuation interest acquired by a NZ resident will remain a FIF

18. As noted in last week's *Weekly Comment*, a foreign superannuation interest acquired when a person is a tax resident of New Zealand will continue to be treated as a FIF and will be taxed on an accrual basis. This is clear from paragraph (a) of the definition of *FIF superannuation interest* in paragraph 5 above.

19. This is because of the risk that the receipts-based approach would allow foreign retirement savings by a New Zealander to remain untaxed if that person left the country to go and live abroad. There would be no New Zealand tax payable if a withdrawal was not made before leaving the country.

20. It follows that these taxpayers would remain liable for unpaid FIF tax relating to previous non-compliance.

Temporary reduced-rate amnesty for pre-1 April 2014 lump sum withdrawals

21. An optional treatment of withdrawals from a foreign superannuation scheme applies when a person:

    (a) Derives an amount from a foreign superannuation scheme as a withdrawal, other than a pension or annuity, in the period beginning on 1 January 2000 and ending with 31 March 2014; and

    (b) Does not include the withdrawal (the *omitted withdrawal*) in a return of income for the income year in which the amount was derived; and

    (c) Is not assessed before 1 April 2014 for income included in the omitted withdrawal; and

    (d) Chooses to include in a return of income for an income year (the *return year*) that is *the 2013-14 or 2014-15 income year* an amount of assessable income as relating to all omitted withdrawals from the foreign superannuation scheme.

22. The person is treated as deriving in the return year from the omitted withdrawals an amount of assessable income (the *withdrawal income*) equal to 15% of the total amount of the omitted withdrawals.

23. The amount of the liability of the person for income tax (the *withdrawal tax liability*) arising from the omitted withdrawal is the difference between the person's income tax liability for the return year, with the withdrawal income included in the person's assessable income for that year, and the income tax liability that the person would have for the return year if the withdrawal income were not included in the person's assessable income for that year.

24. This concession overrides the law applying to the taxation of:

    (a) The omitted withdrawals when the person derived the omitted withdrawals; and

    (b) The person's interest in the foreign superannuation scheme for the period ending by 31 March 2014 in which the person had the interest.

25. The following points are relevant:

    (a) Taxpayers are not required to use the 15% option proposed in the bill and may instead choose to apply the law as it existed at the time;

    (b) The proposed legislation has been amended to make it clear that non-compliant FIF taxpayers who made a lump-sum withdrawal before 1 April 2014 will have the 15%

option available to them – i.e. the FIF rules up to 31 March 2014 are overridden (see paragraph 24 above);

(c) The 15% option will not be available for lump sum withdrawals after 31 March 2014: the policy intention is that taxpayers who derive a lump sum on or after 1 April 2014 would be subject to the proposed new regime;

(d) The proposed legislation previously specifically provided for the omitted withdrawals to be returned in an income year later that the 2014-15 income year: this has been removed, and a request for reassessment of the 2014-15 income year will need to be made for withdrawals returned after the return for that year has been filed;

(e) The proposed legislation previously specifically proved for a due date for the payment of the withdrawal tax liability, which was the terminal tax date for the return year; this has been removed, so the withdrawal tax liability will need to be taken into account in provisional tax payments for the 2014-15 income year.

Consequent changes to the dividend and trust tax rules

26. A foreign superannuation withdrawal derived by a person from a company will not be a dividend. The amended legislation reported from the Finance and Expenditure Committee has also clarified that a pension paid by a company that is a foreign superannuation scheme is not a dividend – the pension is taxed as a pension under the ordinary tax rules.

27. A foreign superannuation withdrawal will not be a taxable distribution from a foreign trust. The amended legislation reported from the Finance and Expenditure Committee has also clarified that a pension paid by a trust that is a foreign superannuation scheme is not taxed under the trust rules and will not be a taxable distribution – the pension is taxed as a pension under the ordinary tax rules.

28. A person who makes a contribution to a trust that is a foreign superannuation scheme will not be regarded as a settlor of the trust. This means that contributions to a superannuation scheme from a person made while they are New Zealand resident will not result in the foreign trust becoming a non-complying trust. Officials declined a submission that this amendment should be retrospective, rather than applying from 1 April 2014.

Detailed PDF attachment on the new rules

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

Arun David, Director

DavidCo Limited