Taxation of foreign superannuation

Why are changes being made?

The current rules for taxing New Zealand tax-residents on their interests in foreign superannuation schemes are complex. Tax may be imposed under a number of different regimes, including the foreign investment fund (FIF) international tax rules, the dividend rules, and the trust distribution tax rules. It can be difficult to determine whether the FIF rules or other tax rules apply.

Depending on which set of rules applies, your foreign superannuation is taxed either on an annual basis calculated on the value of your investment (under the FIF rules), or at the time you receive the income (for instance, a pension payment, a lump sum withdrawal, or a transfer to another scheme). The application of different rules can lead to differing results across people in similar circumstances.

What are the proposed new rules?

Under the proposed new regime for taxing your foreign superannuation, as outlined in the officials' issues paper, the FIF rules would no longer apply. You would only need to consider whether you have New Zealand tax to pay when you receive a pension payment or lump sum, or when you transfer your superannuation to another scheme.

If you receive a pension payment, you would be taxed as many always have been – at your individual marginal tax rate (ranging from 10.5% to 33%).

A lump sum withdrawal or a transfer to another scheme would be taxed depending on how long you have been in New Zealand before you withdraw or transfer. Only a portion of the lump sum would be included in your taxable income. The remainder would not be taxable. This is called the inclusion rate approach.

The proposed new rules are intended to be simple and easy to comply with.

What is the inclusion rate approach?

Once the necessary legislation is enacted, the inclusion rate approach would apply to lump sum amounts, both withdrawals and transfers to another scheme. Instead of paying tax on your foreign superannuation annually, this approach means that the tax liability on your foreign superannuation is typically deferred until you receive the income.

The extent of the lump sum that would be included in your taxable income, on which you apply your marginal tax rate, would depend on how long you have been a New Zealand tax-resident for before you receive the lump sum. The longer the duration, the greater the amount that would be included in your taxable income. The proportion of the lump sum to be included would range from 0% (in the first two years) to 100% (after 25 years).

When would the new rules apply from?

Once the legislation is enacted, the new rules would apply to income received from a foreign superannuation scheme – including pension payments, withdrawals and transfers to another scheme – on or after 1 April 2011.

However, if your interest in a foreign superannuation scheme was taxed under the FIF rules in the 2010–11 income year or earlier years, and you declared this income in your tax return by 31 March 2012, you would continue to apply those rules instead.

Separate rules may apply to transfers or withdrawals of foreign superannuation made between 1 January 2000 and 31 March 2011. These are explained below.

I transferred my superannuation to New Zealand several years ago and did not pay any tax on the lump sum amount. What do I do now?

In some cases, no tax would have been payable on the lump sum. This is true if you had been properly declaring income on your foreign superannuation under the FIF rules at the time you transferred. You will have no further tax to pay on that lump sum amount.

In other situations, the FIF rules would not have applied and so tax on the lump sum may have been payable. If you were not applying the FIF rules to your foreign superannuation at the time you transferred, once the proposals become law you can apply a single low inclusion rate to your withdrawal or transfer. The issues paper proposes that a small portion of the lump sum (such as 15%) would be included in your taxable income, on which you would pay tax at your marginal rate. The remainder would not be taxable. No use-of-money interest or penalties would apply. Alternatively, you can use the relevant tax rules that existed at the time of the withdrawal or transfer, along with use-of-money interest and relevant penalties. This option would be available for transfers and withdrawals between 1 January 2000 and 31 March 2011.

If you choose to apply a single low inclusion rate to your lump sum and the proposals in the issues paper become law, you would need to notify Inland Revenue before 1 April 2014. Details of how to make this disclosure will be provided once the policy has been finalised.

I am a transitional resident and want to withdraw my superannuation from the foreign scheme. Do I have to do anything?

New migrants who have been away from New Zealand for at least 10 years may qualify as a transitional resident if they arrive after 1 April 2006. Transitional residents are exempt on most types of foreign income, including foreign superannuation, for approximately the first four years of being a New Zealand tax-resident.

If you are a transitional resident, your foreign superannuation – including any withdrawals or transferred amounts – is not subject to New Zealand tax as long as you remain a transitional resident.

Under existing law, any earnings (such as interest income) on an amount of superannuation that is brought to and invested in New Zealand may be taxable while you are a transitional resident. This tax treatment is not affected by the proposals.

I have superannuation in a foreign scheme from when I worked overseas, which I have not yet brought to New Zealand. Do I have to do anything?

If your superannuation is still in the foreign scheme, you would not need to do anything under the proposed new rules until you receive a pension or lump sum, or transfer to another scheme. At that point, and once the necessary legislation is enacted, you would either pay tax on your pension or apply the inclusion rate to the lump sum withdrawal or transfer and pay tax on the result.

Alternatively, if you previously paid tax under the FIF rules on your foreign superannuation in the 2010–11 or earlier income year by 31 March 2012, you would continue to apply the FIF rules. Any income that you actually receive would not be taxed under the proposed new rules.

I ceased being a transitional resident in the 2011–12 income year. In that year, I paid tax under the FIF rules on my foreign superannuation for the first time. Am I able to continue to use the FIF rules?

To be able to continue using the FIF rules in future income years, the current proposals would require you to have returned FIF income for the 2010–11 income year by 31 March 2012.

As you were not subject to the FIF rules in the 2010–11 income year due to being a transitional resident, once these proposals become law you may not continue to use the FIF rules. When you receive income from your foreign superannuation scheme in the form of a lump sum or pension, you would be taxed under the new rules. Any FIF tax that you have already paid would be refunded to you or used to offset any tax payable on receipt of the income.

I have superannuation in an Australian scheme and want to transfer it to New Zealand. How will this be affected?

In most situations, foreign superannuation held in an Australian superannuation scheme would not be taxable annually under the FIF rules. Instead, you would need to consider how it would be taxed when you make a lump sum withdrawal or transfer.

Under the Australia-New Zealand double tax agreement, if you receive a lump sum amount from Australia under a retirement benefit scheme, or in consequence of retirement, it is not taxable in New Zealand. You would not be taxed under the proposed new rules.

If the double tax agreement does not apply, transfers into a KiwiSaver scheme from an Australian superannuation scheme may still be tax-free under an agreement on the portability of retirement savings between Australia and New Zealand. This is not yet in force, but will come into effect shortly after both countries inform each other that the necessary legislation has been enacted. In New Zealand, the relevant legislation was passed in 2010.

Once your superannuation has been brought to and invested in New Zealand, any investment gains (such as interest income) will be taxable under existing law. That is, the current tax treatment of such income will be retained.