TAXATION OF FOREIGN SUPERANNUATION

Answers to some frequently asked questions

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Why are changes to the taxation of foreign superannuation being introduced?

Like most countries, New Zealand taxes its residents on income-earning assets that they hold in New Zealand and overseas. This includes interests in foreign superannuation schemes. A foreign superannuation scheme is a scheme created outside New Zealand to provide people with retirement benefits.

The current rules for taxing foreign superannuation can be complex and difficult to comply with, particularly when people transfer their foreign superannuation as a lump sum into a New Zealand superannuation scheme. In some cases people must pay tax on receipt under complex rules, while many others are required to pay tax on an annual basis on their foreign superannuation scheme under the "foreign investment fund" (FIF) rules, even when they have not received any money. If someone pays tax under the FIF rules, they do not pay tax on any payments they receive from the scheme.

The New Zealand Government has proposed changes to the rules for taxing foreign superannuation interests held by New Zealand tax residents to make them fairer and simpler.

The proposed rules contain a special provision to help taxpayers who haven't complied in the past to come up to speed with their tax obligations. See *"I have heard about something called the '15% option'. Can you tell me more about it?"* for further information about this.

Who do the new rules apply to?

The new rules will apply to New Zealand residents who have an interest in a foreign superannuation scheme that was acquired while they were non-resident. This would include new migrants and returning New Zealanders who have been overseas to work.

The new rules will not apply to interests held by New Zealand residents in Australian superannuation schemes.

The new rules will not change the longstanding existing tax rules for pensions that are paid periodically from an overseas source, which are generally taxed in full on receipt.

I was already resident in New Zealand when I got my interest in my foreign superannuation scheme. Do the new rules apply to me?

No. The new rules only apply if you first acquired your interest in your foreign superannuation scheme while non-resident.

If you were already resident in New Zealand when you first acquired your interest in your foreign superannuation scheme, you will generally need to account for tax under the FIF rules. If the FIF rules apply to you, then you need to pay tax on your interest on an annual basis even if you do not receive any payments from your scheme. However, you will not need to pay any New Zealand tax when you do receive payments.

I have an interest in an Australian superannuation scheme. How is this taxed?

Under existing law, lump-sum payments from Australian superannuation schemes are exempt from New Zealand tax.

Pensions from Australian superannuation schemes received by New Zealand residents are exempt from tax in New Zealand, if they would be exempt from tax in Australia if the person was resident in Australia.

You do not generally need to return income under the FIF rules in relation to your Australian superannuation scheme.

I currently receive a pension and return it in my tax return. What do I do now?

No changes are being made to the tax treatment of pensions.

Pensions are generally periodic payments. Lump sums tend to be one-off payments. Under the current law, pensions are generally taxed in full at the person’s marginal tax rate. This means that you should continue to return your pension in your income tax return.

What are the proposed rules?

If enacted, from 1 April 2014, people who acquired their interest in a foreign superannuation scheme while non-resident will be taxed on that interest only when they actually receive a payment from the scheme or when they transfer their interest to a New Zealand or Australian superannuation scheme. The FIF rules will not apply to their interest. This means that people will not need to do anything until the time that they transfer their scheme, or receive a pension or a lump-sum amount from their foreign superannuation scheme.

The proposed rules will be a simpler and more consistent way of taxing amounts that are received as lump sums from foreign superannuation schemes.

In addition, the proposed rules provide a four-year window during which new migrants and returning New Zealanders may receive lump-sum withdrawals and transfers with no New Zealand tax to pay. This is in line with the existing four-year exemption available to certain new migrants in relation to their foreign income.

A "lump sum" in the context of the proposed rules includes:

- a one-off withdrawal in cash;
- a transfer into a New Zealand superannuation scheme, including KiwiSaver;
- a transfer into an Australian superannuation scheme; and
- depending on the circumstances, a transfer of your interest into someone else's name.

For lump sums received on or after 1 April 2014, the proposed rules aim to tax the gains that have accrued to a person's foreign superannuation scheme while they have been living in New Zealand. From a New Zealand tax perspective, the new rules have been designed so as not to provide a tax incentive to either transfer their funds to a New Zealand scheme when they first arrive, or leave it with the foreign scheme provider.

The new rules also provide that transfers from one foreign scheme to another foreign non-Australian scheme will be exempt from tax (although transfers to an Australian scheme are taxed). If a New Zealand resident transfers from one foreign scheme to another, then eventually to a New Zealand superannuation scheme, they won't be taxed until the time of transfer into the New Zealand scheme, but the amount of tax will take into account the gains made by both foreign schemes while they were New Zealand-resident.

There are two methods proposed from 1 April 2014 that allow a person to calculate the tax payable on their lump sum, both of which aim to put the person in a similar tax position to the one they would be in, had they transferred their foreign superannuation scheme to New Zealand when they first migrated:

- *The schedule method*: In most cases, the tax will be based on a graduated, percentage-based scale depending on how long a person has been living in New Zealand.
- *The formula method*: An alternative method is available for people who have a defined contribution scheme and have sufficient information to calculate the actual gains that have accrued to their scheme while they have been living in New Zealand.

There is a special provision that will help taxpayers get up to date with their tax obligations if they have not complied in the past. This option is available when a person has received a lump sum or transferred their foreign superannuation scheme to another scheme (or has applied to their foreign scheme provider to do so before 1 April 2014), and has not complied with the tax rules that apply to their scheme. They have the option of including 15% of the lump sum in their 2013–14 or 2014–15 income tax return and paying tax on that amount.

Will the proposed rules tax the entire capital amount of my foreign superannuation?

The proposed rules will not generally tax the entire capital amount of the lump sum that is received. Rather, the rules will tax only a portion of the lump sum that is received or transferred.

The portion that will be taxed represents tax that should have been paid on the income earned while living in New Zealand. It will not tax amounts that have accrued while you were not a New Zealand resident.

Do I *have* to transfer my funds to a New Zealand scheme?

No, there is no requirement to withdraw or transfer your foreign superannuation to New Zealand.

Transfers or withdrawals before 1 April 2014

I have heard about something called the "15% option". Can you tell me more about it?

The 15% option was proposed to help people who withdrew a lump sum or made a transfer from their foreign superannuation scheme and did not comply with the rules that applied at the time.

Under the proposed new rules, the 15% option will be available if you have received a lump sum from your foreign superannuation scheme or transferred your foreign superannuation scheme to another superannuation scheme (or applied to your foreign scheme provider to do so) between 1 January 2000 and 31 March 2014, *and* did not comply with the tax rules that applied at the time.

You will need to include 15% of your lump sum in your 2013–14 or 2014–15 income tax return. You will pay tax on that amount at your marginal tax rate. For example, if your marginal tax rate is 33%, you will effectively pay tax of just under 5% on the value of the transfer.

There will generally be no use-of-money interest or late payment penalties charged if you use the 15% option.

The 15% option is not compulsory. If you do not want to use it, you must calculate your tax liability under the law that existed at the time of withdrawal or transfer, but keep in mind that you might be subject to penalties and interest in relation to any overdue tax.

If you correctly complied with your tax obligations at the time (including if you correctly calculated a zero tax liability), you do not need to do anything.

I arrived in New Zealand in 2004 and transferred my foreign superannuation in 2007. I didn't think I had any tax to pay, but now I'm not sure. What do I do now?

You have two options under the proposed rules.

You can use the "15% option" provided for in the new rules. (*See "I have heard about something called the '15% option'. Can you tell me more about it?"*)

Alternatively, you can calculate and pay tax under the tax rules that applied at the time. If you correctly calculate that you actually had no tax to pay under the rules that applied at the time, then you have no further tax to pay. If you were required to pay tax under the rules that applied at the time, you will need to pay this tax. You may also be subject to penalties and interest in relation to the overdue tax.

I arrived in New Zealand in 2007 and transferred my foreign superannuation in 2009. My accountant advised that I had no tax to pay on the transfer because I was a "transitional resident". Do I suddenly have to pay tax on this now?

No – the new rules do not impose any further tax on past withdrawals.

You do not have to pay any tax if you correctly calculated and paid your tax at the time. This includes if you had no tax to pay because of rules that existed at the time, such as the "transitional resident rules" which provides a 4-year exemption for foreign income of people who arrived after 1 April 2006 and meet certain criteria.

I want to make a withdrawal from my foreign superannuation fund and use the "15% option", but I don't know if my fund can finalise the withdrawal before 1 April 2014.

It is proposed that if you have applied to your foreign superannuation scheme for the release or transfer of funds by 31 March 2014 you can still use the 15% option, even if the foreign scheme has not transferred it by then.

Keep proof of your application to the foreign scheme in case it is needed.

I haven’t transferred or received a payment yet

I migrated to New Zealand in 1995 with an interest in a foreign superannuation scheme. I haven’t yet received any payments from it. Now I’ve been told that I was supposed to have paid yearly tax on it under the “foreign investment fund” rules. Is this true? Do I have to pay back-tax for these years?

Under the current tax rules, an interest in a foreign superannuation scheme is subject to tax under the foreign investment fund (FIF) rules in many cases. If the FIF rules apply, you are required to account for tax on your interest annually (even if you don’t receive any payments from the scheme). Some people were not aware of this.

Under the proposed rules, if your foreign superannuation interest was subject to the FIF rules but you did not comply and you have not received any payments from the scheme, you will <u>not</u> have to pay back-tax in relation to your interest.

This means that you won’t need to do anything at the moment.

You will only have to pay tax when you actually receive a pension or lump-sum payment from the foreign superannuation scheme or when it is transferred to a New Zealand or Australian scheme.

I currently pay tax on my interest in a foreign superannuation fund under the FIF rules. What should I do from 1 April 2014?

If you have filed an income tax return with FIF income or loss attributed to your foreign superannuation scheme <u>before</u> 20 May 2013, you can choose to continue to use the FIF rules. If you choose to continue with the FIF rules, you will need to file an income tax return including your FIF income or loss every year until you receive your final distribution. You do not need to return tax on distributions from the scheme.

If you have not filed a return of income including FIF income or loss before 20 May 2013, you will not be able to use the FIF rules after 1 April 2014. Instead you will have to calculate tax under the new rules when you receive a pension or a lump sum.

Alternatively, you will have the option to pay tax upon receipt under the proposed rules. You will not be able to get a credit for the tax that you have already paid under the FIF rules.

Transfers or withdrawals on or after 1 April 2014

What should I do when I receive a payment from my foreign superannuation scheme or make a transfer on or after 1 April 2014?

If the payment is a pension, you will generally need to include the gross amount in your tax return.

If the payment is a lump sum (or a transfer to a New Zealand or Australian superannuation scheme), you will generally need to calculate the amount of tax payable using either the *schedule method* or the *formula method*. These two methods are discussed further in *"What are the proposed rules?"*

I want to transfer my fund from my foreign superannuation scheme to another foreign superannuation scheme. Do I need to pay tax on the transfer?

Under the proposed rules you will generally not need to pay tax on the transfer, unless the transfer is to a scheme in New Zealand or Australia.

I’ve received a payment which has had foreign tax withheld on it. Do I still have to pay New Zealand tax on it?

Under existing law, you generally need to include the gross (pre-foreign tax) payment in your New Zealand income tax return. (If you will be returning a lump sum under the schedule method or the 15% option, then you multiply the gross payment by the percentage given under the schedule method, or by 15% if you are using the 15% option).

Whether you are entitled to any relief in New Zealand for amounts paid overseas depends on whether there is a “double tax agreement” (DTA) between New Zealand and the country from which the payment is made.

DTAs are treaties between two countries that establish which country has taxing rights over certain types of income. They provide a mechanism for ensuring that income is not taxed twice.

Under almost all of New Zealand’s DTAs, most pensions and other payments made in respect of retirement (such as lump sums paid from superannuation schemes) are only taxable by the country in which the person receiving the payment is resident. In most cases, the country from where the payment is made is not allowed to tax the payment. This is the way in which most DTAs provide relief from double taxation in respect of pensions.

This means that most pensions and lump sums paid from a foreign superannuation scheme to a New Zealand resident should only be taxed by New Zealand.

If this is the case and foreign tax has been withheld on the pension or lump-sum payment, you would generally be entitled to claim tax relief (for example, by seeking a tax refund) from the foreign tax authority. You should generally not claim the foreign tax as a credit in your New Zealand income tax return.

It is important to check the provisions of the DTA of the country from which the payment is made, as the provisions of each DTA can differ. In particular, the rules for pensions paid by foreign Governments can sometimes be different. All of New Zealand’s DTAs can be found on Inland Revenue’s tax policy website.

Where there is no DTA with the other country, and if the foreign tax is of substantially the same nature as New Zealand income tax, then you can generally claim a foreign tax credit in your tax return. The tax credit claimed must not be more than the amount of New Zealand tax relating to that pension or lump sum.

Where can I find more information about the proposed changes?

Information about the proposed changes in the Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Bill can be found here: http://taxpolicy.ird.govt.nz/news/2013-05-20-foreign-super-tax-bill-introduced.

The bill's progress can be followed on Parliament's website, www.parliament.nz, in the "Bills" section.

Inland Revenue will also provide information about the new rules on its website and in pamphlets when the new rules are enacted.