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WEEKLY COMMENT: FRIDAY 7 JUNE 2013

1. The *Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Bill* ("the Bill") was introduced on 20 May 2013. This week and next week I am looking at the new foreign superannuation withdrawals rules. The new rules will apply from 1 April 2014.

2. This week, I look at the inclusions and exclusions, circumstances in which the FIF rules can continue to apply, and the reduced-rate temporary amnesty for pre-1 April 2014 withdrawals. Next week I will look at the new methods for calculating taxable income.

3. The topics covered this week are:

   (a) Inclusions;

   (b) Transitional resident exemption;

   (c) Initial period of residency exemption;

   (d) Australian superannuation scheme withdrawal exemption;

   (e) Exemption for transfers between two foreign (non-Australian) superannuation schemes;

   (f) Exemption for transfers upon death;

   (g) Exemption for amounts in excess of the assessable withdrawal amount;

   (h) Blanket FIF exemption except for FIF superannuation interests;

   (i) Temporary reduced-rate amnesty for pre-1 April 2014 withdrawals;

   (j) Dividend exemption and trust rules exemption.

Inclusions

4. Under the new rules, the FIF rules will no longer apply, and taxable income will arise under the general rules for a person and a benefit (a *foreign superannuation withdrawal*) that:

   (a) Is not a pension or annuity; and

   (b) Is derived by a person from a *foreign superannuation scheme*; and

   (c) Is in the form of:

      (i) An amount derived by the person as a member or beneficiary of the scheme; or

      (ii) A right of the person to benefit from distributions from the scheme, withdrawn for reinvestment as an interest of the person in a superannuation scheme in New Zealand; or

(iii) A right of the person to benefit from distributions from the scheme, outside Australia, withdrawn for reinvestment as an interest of the person in a superannuation scheme in Australia; or

(iv) A right of the person to benefit from distributions from the scheme (anywhere) withdrawn, *other than on the death of the person*, for reinvestment as an interest of another person in a superannuation scheme (rollover relief for transfers on death).

5. 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.

Transitional resident exemption

6. The transitional resident exemption in s. CW 27 applies to a foreign superannuation withdrawal derived by a resident while that person is a *transitional resident*. Under that exemption, a withdrawal, from a foreign superannuation scheme, that relates to a right to benefit that was acquired before the person became a transitional resident, will be regarded as a foreign-sourced amount that is exempt income.

7. Under s. HR 8(2) a person who is a New Zealand tax resident is a *transitional resident* if the person was a non-resident for at least 10 years before becoming a NZ tax resident, and has not been a transitional resident of New Zealand previously.

8. The exemption period is the period that begins on the first day of New Zealand tax residence, and ends on the last day of the 48th month after the month in which New Zealand tax residence began (or when the person stops being a New Zealand tax resident, if that is earlier).

9. 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. The transitional resident exemption may not apply because a withdrawal relating to such an interest may be regarded as having been sourced in New Zealand.

Initial period of residency exemption

10. The initial period of residency exemption in s. CW 28B will apply to a foreign superannuation withdrawal derived by a New Zealand tax resident during the period of initial tax residence in New Zealand if:

(a) The person is not a transitional resident (for some reason) during the period of initial residence; and

(b) The withdrawal relates to an interest in a foreign superannuation scheme that was acquired wile the person was a non-resident or regarded as non-resident under a double tax agreement.

11. The withdrawal is derived during the period of initial tax residency, which is the period:

(a) Which starts on the date the exemption commences; and

(b) Which ends 48 months after the month in which the exemption commenced (or when the person stops being a New Zealand tax resident, if that is earlier).

12. Note again that under proposed new s. CF 3(3), the exemption period will not be available for interests that were acquired while the person was resident in New Zealand. The foreign superannuation interest must have been acquired before the person became a New Zealand tax resident at a time when:

    (a) The person was not a transitional resident; and

    (b) The person had not enjoyed an exemption period earlier (than when the interest was acquired).

Australian superannuation scheme withdrawal exemption

13. 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 will take effect from 1 July 2013). This treatment will continue under the new rules."

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

14. 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).

15. 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.

    <u>Example:</u> 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 transfers upon death

16. An interest withdrawn on the death of a person, for reinvestment as an interest of another person in a superannuation scheme, is excluded from being taxable income. It is stated on page 6 of the *Commentary* to the Bill that:

    "Rollover relief will also be provided when a deceased person's interest in a foreign superannuation scheme is transferred directly to a New Zealand resident. The transfer will not be taxed. Instead, the recipient will be taxed on the eventual withdrawal or transfer

(subject to the rollover relief discussed above), *based on the duration of New Zealand residence of both the recipient and the deceased*. (emphasis added)

Example: Matthew moved to New Zealand in 2016 to be closer to his New Zealand-based daughter Jenny. Matthew died in 2023, seven years after migration. Matthew had an interest in a foreign superannuation fund which was acquired while non-resident. His foreign superannuation was transferred to Jenny under his will, and was not taxed at that time. Jenny withdraws the foreign superannuation in 2026, after her father's death. She is treated as having acquired the foreign superannuation interest in 2016, which is when Matthew first became resident after acquiring the interest."

Exemption for amounts in excess of the assessable withdrawal amount

17. A foreign superannuation withdrawal derived by a resident is exempt income of the person under s. CW 28C, if the foreign superannuation withdrawal is derived in the person's *assessable period* (essentially the period following an initial exemption period), to the extent to which the foreign superannuation withdrawal exceeds:

    (a) The assessable withdrawal amount calculated under the *formula method*, if the person qualifies to use this method, and chooses to use it; or

    (b) The assessable withdrawal amount calculated under the default *schedule method*.

Blanket FIF exemption except for FIF superannuation interests

18. Under new s. EX 42B, 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 from a foreign superannuation scheme.

19. *FIF superannuation interest* means, 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 meets the following requirements:

    (a) For the *current year*, the FIF must have been a foreign superannuation scheme; and

    (b) The person must have had an attributing interest in a FIF for a previous income year (the *qualifying year*) that ended before 1 April 2014; and

    (c) The person must have had, for the *qualifying year*, FIF income or loss resulting from that attributing interest; and

    (d) The FIF income or loss for the *qualifying year* must have been included in a tax return filed with Inland Revenue by 20 May 2013, the date of introduction of the Bill; and

    (e) The person must have held the FIF superannuation interest for the entire *qualifying period*: the period starting from the end of the *qualifying year* to the beginning of the *current year*.

20. A person who does not meet these criteria by 1 April 2014 may not continue to use the FIF rules for the 2015 income year (commencing 1 April 2014) or subsequent years. Note also that these criteria must be met *each time* a person seeks to apply the FIF rules (that is every income year from 1 April 2014). 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. The person must pay tax under the new rules on any subsequent withdrawal.

21. Only a person who meets these criteria will have the option to either continue to return income under the FIF rules (that is, they will be grandparented), or to apply the new rules instead. If a person has two or more interests in foreign superannuation schemes, the criteria are assessed per interest (not just once for that person).

22. A person whose foreign superannuation assets are valued at less than the $50,000 minimum threshold in section CQ 5(1)(d) may choose to apply the FIF rules in this manner, as long as the above criteria are satisfied.

23. If a person continues to apply the FIF rules, any withdrawals or transfers in relation to that foreign superannuation interest will not be taxed under the proposed new rules.

24. The following example is provided in the *Commentary* on the Bill:

    "**Example:** Aaron is a migrant to New Zealand and acquired a permanent place of abode in May 2006. He was a transitional resident until the end of May 2010. For the 2011 income year, Aaron complied with the FIF rules in relation to his foreign superannuation interest, and included the FIF income in his tax return before the filing date. He does not return FIF income in relation to this interest in the 2012 to 2014 income years because the interest qualified for a FIF exemption following a change in the foreign superannuation scheme's rules which made it locked-in. As at 1 April 2014, the criteria are still satisfied as Aaron correctly returned FIF income in the 2011 income year. Despite the exemption, Aaron will have to return FIF income in relation to his interest for the 2015 income year in order for it to remain grandparented."

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

25. An optional treatment of withdrawals from foreign superannuation schemes 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*) ending on or after 31 March 2014 an amount of assessable income as relating to the omitted withdrawal.

26. The person is treated as deriving from the omitted withdrawal an amount of assessable income (the *withdrawal income*) equal to 15% of the amount of the omitted withdrawal.

27. 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.

28. The amount of the withdrawal tax liability arising from the person's return of income for the return year has a due date for payment corresponding to the due date for payment of the

person's terminal tax for the earlier of the return year and the person's 2014–15 income year.

29. This concession overrides the law applying to the taxation of the omitted withdrawal when the person derived the omitted withdrawal.

Consequent changes to the dividend and trust tax rules

30. A foreign superannuation withdrawal derived by a person from a company will not be a dividend.

31. A foreign superannuation withdrawal will not be a taxable distribution from a foreign trust.

32. 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.

Detailed PDF attachment on the new rules

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

Arun David, Director

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