INVESTMENTS HELD OUTSIDE AUSTRALIA: FOREIGN INVESTMENT FUND ISSUES

If you are an individual living in Australia with a permanent residency visa or under a temporary visa that was issued more than four years ago two particularly nasty pieces of tax law can have a significant effect on your wealth: what is known as the Foreign Investment Fund legislation, and section 27CAA of the Income Tax Assessment Act 1936.

The FIF rules were introduced with effect from the 1st of January 1993, and are intended to reduce the extent to which residents of Australia can defer tax by holding interests in entities that are outside Australia – even if this was not the original intention when an original investment was taken out, as is often the case when individuals move to Australia holding investment products taken out in their former country of residence.

The problem as seen from the perspective of the Commonwealth Government and thus the Australian Taxation Office, was that prior to the implementation of the FIF measures (and certain other tax laws which are not dealt with here), individuals could shelter income outside Australia in offshore companies and trusts, where the income was not distributed to the Australian resident. As such, income could be accumulated for the Australian residents future benefit, and indeed, for those who were able, could be distributed at a future date when the individual had taken steps to become resident outside Australia.

The solution, so far as the Australian Government was concerned, was to tax income as it accrued, and the FIF legislation was introduced to counter this perceived tax avoidance.

In broad terms, the law works by defining a FIF widely as being “any foreign company or foreign trust,” and a Foreign Life Policy as being “a life assurance policy issued by an entity that was a non-resident of Australia at any time in the income year.” Subject to certain exemptions (more of which below), an individual who is a resident of Australia at any time during an income year, and who holds an interest in a FIF or a FLP at the end of that income year (ie at 30th June) is required to include FIF or FLP “income” within assessable income on their Tax Return.

For the UK resident moving to Australia this can have a particularly adverse result. The following types of investment that are typically held by a UK-resident are caught by the FIF rules:

- Endowment policies
- Whole of life policies (which typically have a surrender value attaching)
- With profits bonds (whether held UK or ex-UK)
- Personal pension policies
- Personal equity plans (PEPs)
- Individual Savings Accounts (ISAs)

The practical effect is that an individual emigrating to Australia with a permanent residency visa who continues to maintain any of the above policies (even if no further contributions are made) will be required to include the increase in the value of the policy or plan from one year to the next in his or her tax return – **even if the funds cannot be extracted to pay the tax that is due**. This is a particular issue for endowment policies that are approaching maturity where significant value usually arises by way of terminal bonus, and for personal pension policies where one cannot access the fund value until the stated retirement age.

An individual moving to Australia with a permanent residency visa must therefore give serious thought as to whether he or she is content to pay tax in Australia on what are usually tax effective investments in the UK – at rates of up to 48.5% - whilst allowing the policy to continue to grow within the UK, or whether it would be preferable to transfer the fund into a suitable investment vehicle in Australia. This decision will usually be a function of longer term plans, and it might be that the decision is deferred and FIF tax is paid for a year or two whilst the taxpayer establishes whether his or her long term future is in Australia.

It is worth re-iterating here that the FIF rules only take effect if an Australian resident taxpayer holds an interest in a FIF at 30th June – depending on the date of entry into Australia this might allow quite a reasonable period of time for the taxpayer to formulate a suitable strategy. For example, if an individual arrives in Australia in July with a permanent residency visa, is considered resident for tax purposes, and purely on the basis of tax issues, there would be over 11 months in which a decision could be made to dispose of the FIF interest before there is a FIF tax issue.

That said, in the context of pension funds one must also have regard to section 27CAA of the Income Tax Assessment Act 1936. In general terms, this section states that a taxpayer must include lump sums from "non-resident non-complying superannuation funds" within assessable income in the year in which the lump sum is received. Where an individual has become a resident of Australia the amount to be included in assessable income is only the amount by which the lump sum exceeds the value of the fund on the day before he or she became a resident of Australia. However, **and importantly, our understanding is that for this purpose the Australian Taxation Office does not treat an individual permanently migrating to Australia as being resident until 6 months after he or she has arrived.**

The practical effect of section 27CAA is that delaying a decision about making a pension fund transfer into Australia for more than 6 months can give rise to a requirement to include the increase in the fund's value between the date of arrival in Australia and the date the fund value is received in Australia on the personal Tax Return - and to pay income tax on this amount.

This can drive a decision to make a pension fund transfer within 6 months of arriving in Australia.

Returning to the FIF rules, the main exemptions from the FIF rules are as follows:

- Where the interest is in an **"active business."** An "active business" is as defined by the tax legislation.
- Where the FIF interests of the taxpayer, together with his or her associates, total **A$50,000 or less** at the end of the financial year. Associates is defined in the law – and includes the taxpayer's spouse so long as they are living together, but not where they have been living separately and apart for at least 12 months; a child, whether or not living with the taxpayer; a stepchild living with the taxpayer; a partner in a partnership and a spouse or child of the partner; a company in which the taxpayer and his/her associates have a majority voting influence or which is "sufficiently influenced" by the taxpayer and his/her associates.
- Interests in foreign **employer sponsored** superannuation funds.
- An individual who is a "visitor," meaning that all of the following conditions are satisfied:
    - The taxpayer holds a **temporary visa**
    - The period of time from the issue date of the **first** entry visa that is current until expiry date is 4 years or less. Where the current visa is issued as an extension of an earlier visa, the period of time from the issue date of the earliest visa until the expiry date of the current visa must be 4 years or less.
    - The taxpayer has not made an application for a permanent residency visa.

There are other exemptions, but these are not dealt with here.

In our view this is one of the most difficult areas to plan, and there is no straightforward strategy that fits the circumstances of all people planning to migrate to Australia. The mix of tax legislation and currency exchange risk can create compelling reasons to transfer funds to Australia, but if there is uncertainty as to whether the move to Australia is permanent a measure of delay in transferring investment funds might be preferable.

The contents of this factsheet are necessarily a general overview of a very detailed subject. The situation may change as tax legislation can alter quickly and we therefore strongly recommend that you take professional advice about your personal circumstances before placing any reliance on the contents of this factsheet.

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