Change comes to the way New Zealand taxes foreign superannuation funds

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The way New Zealand has traditionally taxed so-called "foreign superannuation funds" has long caused difficulty for people emigrating to New Zealand, as well as for those Kiwis who are returning home after building up pension pots while abroad.

This, though, is about to change. In a recently-introduced piece of legislation known as the Taxation (Annual Rates, Foreign superannuation and Remedial Matters) Bill, pension income and lump-sum payments received from foreign superannuation schemes will be taxed in a way that is closer to that used by much of the rest of the world.

Under the existing New Zealand rules, an interest in a foreign superannuation scheme (that is, one amassed and held outside of New Zealand) is considered an interest in a foreign investment fund (FIF).

Under the FIF rules, tax is payable based on 5% of the value of the person's interest in the superannuation fund. For people correctly returning income on this basis, no other benefit received from that fund is taxable.

However, for some people, the rules give unexpectedly harsh outcomes if a lump sum was received, as this is generally taxable.

Adding to the confusion is that the Inland Revenue Department (IRD) has been content to allow people in receipt of pensions from abroad to pay tax on the pension amount.

So instead of a set of rules that tried to tax the income of the superannuation scheme as it was earned under the FIF rules, New Zealand has decided to return to the more orthodox approach employed by the rest of the world, and tax the income from the foreign pension when it is received as a pension or a lump sum.

failure to comply 'common'

Until now, the incorrect application of New Zealand's tax laws, or general non-compliance, has been relatively common. Under new provisions to be introduced from April 2014, though, a simple system will apply to the withdrawal by New Zealand tax residents of lump sums from foreign superannuation funds, and to lump sum transfers of pension funds to New Zealand from overseas – including,of course, pensions from the UK.

As a part of this, for those who have not paid the correct tax, the government is offering a partial amnesty.

This will apply to lump sum withdrawals or transfers from foreign schemes from 1 Jan 2000 to 31 March 2014. The amounts must be included in the individual's 2013/14 or 2014/15 tax return.

Options for NZ residents

For New Zealand residents with UK pensions still back in Britain, it is important to understand the different tax arrangements in both countries to appreciate the importance of the various options they now face.

In the UK, tax on UK pension funds is not paid during the savings period, and contributions within limits are tax-relieved.
At retirement, tax is paid on income received. This gives a tax advantage during the savings period, but it means paying tax in retirement.

The advantage is that by the time an individual is retired, he or she is earning less, and thus would expect to pay a lower percentage of tax than when they were working, and in a higher-tax band.

New Zealand is the opposite. Tax is paid during the savings period, but not on withdrawals from retirement savings.

This provides an advantage in retirement and a potential advantage to individuals from other countries who may be considering emigrating to New Zealand in retirement.

There are three main groups who will be affected by the new rules.

- **New Migrants**

Most newcomers to New Zealand from other countries have a four-year tax exemption on overseas income which includes private UK pensions. If a new migrant transfers his or her UK pension fund to New Zealand within the four-year exemption, then no tax is payable on the transfer.

However, once the funds are invested in a New Zealand scheme (such as a QROPS), the scheme will pay tax on its investment returns. When it comes time to retire and make withdrawals, no further tax will be deducted from the payment.

This is a potentially huge financial advantage for individuals close to or over the age of 55.

- **Been in New Zealand for more than four years, but not yet transferred**

This group can elect to transfer their UK pension to New Zealand, and pay tax on only 15% of the amount transferred, or leave it in the UK and pay tax on all future benefits.

That includes paying tax on the pension commencement lump sum.

- **Living in New Zealand, and transferred after the four-year exemption**

This group are liable to past taxes. However, the IRD recognises that the rules have been hard to understand, and therefore it is offering an option to pay tax on 15% of the amount transferred.

As a general rule of thumb, this for most amounts to 5% of the pension value.

After the window for the period this option is in effect closes – 31 March 2014 – the existing FIF rules will no longer apply, and people with interests in foreign superannuation will only pay tax when the scheme starts paying a pension, or pays a lump sum.

A transfer of a pension into a New Zealand or Australian scheme will be treated as a lump-sum payment, and therefore will be deemed taxable.

Lump-sum payments are taxable on a sliding-scale basis that increases the tax on the basis of how long a person has been a tax resident of New Zealand.

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