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SUPERANNUATION

New Zealand tax information in relation to transfers of defined benefit pensions requiring FCA reports

Introduction

This report is intended to supplement the information provided directly by an individual who is intending to transfer their UK defined benefit or guaranteed annuity rate pension funds to a New Zealand QROPS.

It is divided into:

- The New Zealand tax treatment of foreign pension schemes owned by New Zealand tax resident individuals;
- The New Zealand tax treatment of benefits received from foreign pension schemes by New Zealand tax resident individuals;
- The New Zealand tax treatment of transfers of foreign pension funds to New Zealand superannuation schemes by New Zealand tax resident individuals; and
- General information about New Zealand's tax system as it relates to New Zealand superannuation schemes for New Zealand tax resident individuals.

Pensions and pension schemes are colloquially known in New Zealand as superannuation and superannuation schemes. The two are interchangeable, and here I use both.

For New Zealand tax purposes, UK pension schemes are in the same category as all overseas pension schemes, but I use the phrase overseas pension scheme and UK pension scheme interchangeably here.

1. NZ tax treatment of foreign pension schemes

The income or gains of foreign pension schemes ceased to be annually taxable on individuals in NZ from 1 April 2014. Before that date, subject to a number of complex exemptions, individuals were technically taxable on the growth in value of their overseas pension fund each year.

From 1 April 2014, individuals became taxable on a notional amount of income calculated when they make lump sum withdrawals. Withdrawals are defined as the transfer of an overseas pension fund to a New Zealand scheme as well as the taking of benefits directly from the overseas scheme.

Under the new rules, transfers between foreign superannuation schemes is not taxable for a New Zealand tax resident provided the transfer is not to an Australian pension scheme. Transfers to Australian schemes are outside of this rollover provision because transfers from Australian superannuation schemes to New Zealand schemes are exempt from New Zealand taxation.

When the rules were introduced in 2014, they were made retrospective, and the old rules were grandfathered. This means that any individuals that transferred their UK pensions after 31 March 2014 who had not applied the 'old' rules, prior to that were required to adopt the new rules as if they had applied at all times. Any individuals who had correctly and consistently applied the old rules could opt to continue using the old rules if doing so was to their advantage.

2. NZ tax treatment of benefits from foreign pension schemes

2.1 The rules if no exemptions apply

Pension income is taxable in full on a receipts-basis, which means that it is taxable in the tax year in which it is received. The word 'pension' is not defined in tax legislation, so it takes its ordinary meaning of being income received on a regular basis from a retirement savings scheme. Any annuity, regular drawdown, or defined benefit pension that is not a lump sum will therefore fall into this category.

A withdrawal from a foreign superannuation scheme that is not a pension (i.e. it is a lump sum) is taxed in a more complex way. The rules that apply were introduced with effect from 1 April 2014 and involve determining:

- When it applies: It applies when there is a:
  - Lump sum withdrawal
  - Transfer to New Zealand
  - Transfer to Australia
  - Transfer of an interest to another person
- When it does not apply: It does not apply to:
  - Transfers of interests under formal relationship property agreements (a formal legal process between couples that does not necessarily involve divorce)
  - Withdrawals within a specified period of exemption
  - Withdrawal amounts in excess of the amounts calculated using one of the two permitted methods
- The Exemption period: This is usually the month of arrival and the following 48 months.

- The Assessable Period: This is generally the period between the end of the Exemption Period and the derivation of the withdrawal.
- The methods permitted to calculate the assessable amount: The two methods are:
  - The Schedule Method
  - The Formula Method

2.2 Exemption period

The exemption period starts when a person first becomes tax resident after they first join a foreign pension scheme and applies for the month of arrival and the following 48-month period. This exemption period can end before the expiry of 48 months if a person becomes non-resident. A person may only have one exemption period.

2.3 Assessable period

An assessable period follows an exemption period, and each tax year that passes tends to increase the amount of notional assessable income that a person must declare and pay tax on if they take a lump sum withdrawal.

Any period of non-residence is not part of an assessable period. For example, if a person joined a UK pension scheme, came to NZ for three years, became non-resident for another five years before returning again, they would effectively have an 8-year exempt/non-assessable period.

2.4 Schedule Method of calculating income

The Schedule Method is the default method of calculation and may be used for defined contribution schemes, but is compulsory for defined benefit schemes. In its simplest form, it requires an individual to count the number of tax years that have started between the end of an exemption period and the foreign superannuation withdrawal (with a minimum of 1). The number derived determines the percentage of the withdrawal that is taxable and is called the Schedule Year Fraction. The more years collected, the greater the percentage of the fund that is taxable.

The Schedule percentages are:

Year	% taxable	Year	% taxable	Year	% taxable	Year	% taxable
1	4.76%	8	36.06%	15	64.08%	22	89.16%
2	9.45%	9	40.26%	16	67.84%	23	95.58%
3	14.06%	10	44.39%	17	71.53%	24	95.83%
4	18.60%	11	48.45%	18	75.17%	25	99.08%
5	23.07%	12	52.45%	19	78.75%	26	100%
6	27.47%	13	56.39%	20	82.28%		
7	31.8%	14	60.27%	21	86.74%		

2.5 Formula Method of calculating income

The Formula Method of calculation may be used for a withdrawal from a defined contribution scheme but cannot be used for a withdrawal from a defined benefit scheme.

A brief description is therefore included here only for completeness. The method requires a calculation of the increase in value of a pension fund from the end of any exemption period to the date of withdrawal. The raw gain is then put through a formula which increases the gain by a factor dependent upon the length of time it has accrued

without NZ taxation being charged. If a pension scheme has decreased in value over this period (e.g. because of exchange rate movements) the income is zero.

The logic for this method not being permitted for interests in defined benefit schemes is that the market value at the date of the commencement of the assessable period is unlikely to be readily available. In some instances, however, the market value at the relevant date has been calculated by an actuary and has been used as a basis to consider transferring a defined benefit interest to a SIPP prior to a transfer to a New Zealand scheme. This would permit the use of the Formula Method, but may be subject to Inland Revenue Department (IRD) scrutiny.

2.6 Lump sums from defined benefit schemes

The IRD's view is that lump sums taken from defined benefit schemes that involve a commutation of an entitlement to income are fully taxable rather than taxable under the rules associated with lump sum withdrawals. The rationale for this is that the lump sum is an advance of income resulting from an option exercised by an individual, not a withdrawal of a capital amount. The form of the payment (i.e. a lump sum) does not change the nature of the payment for New Zealand tax purposes (i.e. it is, and remains, taxable income). An important requirement for this legal principle to apply is that, following the lump sum payment, a pension must commence or continue. There is New Zealand and overseas (including Australian and UK) case law to support this legal position.

Where scheme rules provide for the payment of a non-optional lump sum on the commencement of a pension, the lump sum withdrawal rules would apply to the member's entitlement, and it would not be treated as income.

2.7 Transitional Residence

There is a separate overriding exemption from NZ tax given to new tax residents and to returning residents if they have been tax-resident outside of New Zealand for at least 10 years. This is called Transitional Residence, and it generally results in all foreign passive income being exempt from New Zealand tax for the month of arrival and the following 48 months. Passive income includes interest, dividends, pension payments or withdrawals, rents, and royalties. Any lump sum or regular income benefits from UK pension schemes received in this period are therefore exempt from tax, as are the transfer of any UK pension funds to NZ schemes.

2.8 Summary

In summary:

- The receipt of a pension from a UK pension scheme is fully taxable.
- Lump sums payments that derive from an option to commute part of a defined benefit pension will retain their income nature and will be fully taxable as income in New Zealand.
- Outside of any period of exemption related solely to foreign pension schemes, the receipt of a lump sum withdrawal from a UK pension scheme may be partly or fully taxable, dependent upon the length of New Zealand tax residence, with the amount determined by one of two methods.
- Any pension payments or lump sum withdrawals from a foreign pension scheme during a period of Transitional Residence is exempt from NZ tax.

3. Taxation of lump sum transfers to New Zealand Superannuation schemes

Transfers are treated in the same way as lump sum withdrawals. Accordingly, exemptions, exemption periods, assessable periods and the Schedule and Formula methods apply in the same way.

The transfer of a defined benefit pension fund in payment would be treated as a capital lump sum to which the Schedule Method of income calculation would apply. This is on the basis (as outlined in 2.6) that there would be no ongoing pension payments following the pension transfer.

4. General information about New Zealand's tax system

Tax Year

The New Zealand tax year runs from 1 April to 31 March each year.

Personal allowances

There are no personal allowances in New Zealand

Personal tax rates

Personal tax rates are progressive, and the tax bands are:

Income	Rate
$0 to $14,000	10.5%
$14,001 to $48,000	17.5%
$48,001 to $70,000	30%
$70,000 +	33%

Capital taxes

There are no capital taxes in New Zealand. This includes:

- Capital gains taxes;
- Gift taxes;
- Inheritance taxes

However, where capital gains are considered to have the nature of income in specified ways, the income tax legislation provides for gains to be taxed as income.

Tax reliefs

Expenditure incurred in order to generate assessable income is generally deductible for tax purposes, but there are few tax incentives that relate to investments or savings. In particular, there are no tax reliefs for personal pension contributions, but the antithesis of this is that benefit payments from New Zealand superannuation schemes are not taxed on individuals.

Superannuation Schemes in New Zealand

In broad terms, for tax purposes, superannuation schemes in New Zealand can be categorised as:

- Portfolio Investment Entities (commonly abbreviated to PIEs); or
- Non-PIE but widely held; or
- Non-PIE and not widely held.

A PIE is a unitised investment vehicle that attributes income and gains to individual investors for the purpose of applying tax rates nominated by individuals that must reflect their personal marginal rates of tax. This is designed to remove the tax disadvantage that low earning taxpayers otherwise face when investing in investment vehicles with higher tax rates. The tax rates that investors can nominate (the Prescribed Investor Rate, or PIR) are:

Resident investors:

- 10.5% for those with taxable income up to $14,000 provided their non-PIE and PIE income combined is less than $48,000.
- 17.5% for those with taxable income between $14,000 and $48,000 provided their non-PIE and PIE income combined is less than $70,000.
- 28% where an investor does not qualify for rates of 10.5% or 17.5%.

Non-resident investors

- 0% where the PIE scheme invests mainly in foreign investments and has formally elected to be a Foreign Investment PIE, and the investor qualifies as being a Notified Foreign Investor.
- 28% where the investor does not qualify for the 0% PIR

Widely held superannuation schemes that are not PIEs are taxed at a flat rate of 28%. To be a widely held superannuation scheme, it must have, or must anticipate having, over 20 investors.

A non-widely held, non-PIE superannuation scheme is taxed at a flat rate of 33%.

Payments out of superannuation schemes

Payments of benefits made by New Zealand superannuation schemes are not liable to New Zealand tax in the hands of residents and non-residents alike. This is on the basis that individuals have not had New Zealand tax relief on the contributions to the schemes, and the New Zealand superannuation fund has been taxed on its income in the growth phase.

www.i-select.co.nz

To find out more about i-Select PIE Superannuation Scheme, talk to your financial adviser, visit our website or call us on 03 308 0144.

i-Select Limited
PO Box 274
New Zealand

info@i-select.co.nz
+64 3 308 0144

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