Regulatory Impact Statement

Taxation of foreign superannuation

Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by Inland Revenue.

The problem addressed in this statement is whether the current tax treatment of interests in, and income from, foreign superannuation schemes is appropriate and, if not, how it should be changed.

Key issues were the complexity of the current rules for taxing foreign superannuation held by New Zealand residents, and a lack of clarity on whether the rules resulted in a fair outcome, particularly for lump sum transfers and withdrawals. The complexity arises from the fact that a number of different regimes may apply in taxing interests in foreign superannuation schemes. This has resulted in significant levels of non-compliance, which has been estimated to be approximately 70%.

The issues were first raised by tax practitioners in 2006, and were included in the Government's tax policy work programme in 2011. The policy review focused on the application of the foreign investment fund (FIF) rules to foreign superannuation, and taxing lump sums received from foreign schemes, including both transfers and withdrawals. As there were no concerns about the current tax treatment of pensions, no changes to pensions are proposed, except insofar as those interests are currently taxed under the FIF rules.

The preferred option for reform will replace a number of different regimes (as they apply to foreign superannuation), simplifying the applicable tax rules and improving clarity. It also aims to maintain equity and consistency of tax treatment. It is expected that compliance costs for individuals will be reduced.

The option proposed involves legislating for two calculation methods for lump sums, in order to determine the amount of foreign superannuation which is assessable income. The calculation methods rely on several key assumptions. In particular, the interest rate and the growth rate in the foreign scheme have been calibrated at 5%. Although some submitters in the consultation process were concerned that the 5% rate was too high and may result in over-taxation, we note that since we are providing an alternative method for taxing actual gains, the 5% will effectively act as a cap where actual gains are higher. This is similar to the operation of the fair dividend rate and comparative value methods in the FIF rules.

Significant consultation was undertaken during the policy development process. Officials met with practitioners from several large accounting firms and the financial services industry, and with pension transfer agents. An issues paper released in July 2012 drew 59 external submissions. Key changes arising from the consultations included: deferring the application date from 1 April 2011 to 1 April 2014 as submitters were generally opposed to retrospective legislation, and providing for an alternative method to tax actual investment gains derived while the taxpayer was New Zealand resident.

The fiscal implications of the preferred approach are very difficult to quantify due to a lack of reliable information, but have been estimated to be broadly fiscally neutral based on migration trends and data on previous transfers provided by some pension transfer companies. The existing policy to tax foreign superannuation is continued under the new rules, which are designed to make the rules easier to comply with, rather than to collect any additional revenue.

Other than those set out in this statement, no significant gaps, assumptions, dependencies, constraints, caveats and uncertainties have been identified. The amendments do not impose additional costs, impair private property rights, reduce market competition, provide disincentives to innovate or override common law principles.

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STATUS QUO AND PROBLEM DEFINITION

1. New Zealand tax residents with interests in foreign superannuation schemes are liable for tax on those interests. The current rules for taxing foreign superannuation are complex. Foreign superannuation is taxed either annually under the foreign investment fund (FIF) rules, or at the time the person received the income (for example, as a pension, a lump-sum withdrawal, or a transfer to another scheme).

2. The FIF regime is the default method for taxing interests in foreign superannuation, unless a specific statutory exemption applies to an individual's circumstances. The exemptions recognise that there can be practical problems with applying the FIF rules to foreign superannuation. In particular, as superannuation is often locked in[1] until retirement age, the savings may not be accessible, so the FIF tax liability must be satisfied out of other income. The key exemption relevant to foreign superannuation therefore relates to locked-in employment-related schemes. Subjective elements can make this exemption difficult to apply.

3. A summary of the tax treatment of New Zealand residents' interests in domestic and foreign superannuation schemes is provided in the table below:

General treatment of retirement savings	Foreign retirement savings held by New Zealand residents - FIF rules	Foreign retirement savings held by New Zealand residents - FIF exemption
New Zealand taxes savings on a "taxed-taxed-exempt" (TTE) basis (on accrual). This means: • contributions are made out of after-tax income, • any gains are taxed at the time they are earned, and • all withdrawals are tax-free. Many foreign countries tax their residents' retirement savings on an "exempt-exempt-taxed" (EET) basis (on receipt). This means: • contributions are made before income tax is deducted, • any gains are not taxed at the time they are earned, and • any withdrawals made from the account are fully taxed.	This is default method for taxing foreign superannuation interests held by New Zealand residents: • the individual is required to calculate income or loss in respect of the foreign superannuation interest on an annual basis • there are a number of methods for calculating income under the FIF rules[2] • distributions from the scheme are tax-free • this is in line with the treatment of domestic savings: gains are taxed, but withdrawals are tax-free • since many foreign countries tax foreign superannuation on receipt, there may be some effective double taxation as New Zealand does not provide foreign tax credits for tax paid on receipt.	When a FIF exemption applies, the foreign superannuation interest is still taxable, but under different rules: • the individual does not need to calculate tax in respect of this interest on an annual basis • withdrawals, transfers and pensions are taxable on receipt • the amount of tax to be paid on lump sums depends on factors such as the legal structure of the superannuation scheme, for example a company or trust • it can be difficult to identify the correct tax treatment • the ultimate tax liability may be very different from that resulting from the FIF rules.

[1] A locked-in scheme is one where the provider does not permit withdrawals before retirement age or under certain restricted circumstances, for example, KiwiSaver.

[2] For example, the comparative value and fair dividend rate (FDR) methods. The comparative value method taxes the net increase in the value of the investment during the year. The FDR method taxes a deemed return of 5% of the market value of the person's interest.

4. As illustrated in the table above, the rules for taxing New Zealand residents on their foreign superannuation interests are complex and lack consistency and cohesion. There is particular complexity in respect of lump sums. Tax liability can differ substantially based on whether the FIF rules apply or whether – and how – a distribution is taxed under the dividend or trust tax rules. For example, tax on FIF income is likely to be less than or equal to 1.65% per annum of the market value of the interest, whereas tax on a distribution from a trust may equal fully 30% of the lump sum. This creates inequity between people in similar circumstances. These problems serve to make the status quo unsustainable.

5. Furthermore, the complexity and lack of clarity have led to significant levels of non-compliance, some of which was discovered during compliance activity undertaken by Inland Revenue. Some people were incorrectly advised that an exemption from the FIF rules meant that they were exempt from New Zealand tax altogether. Non-compliance is problematic because these individuals may learn they have significant tax liabilities, after they have spent or invested the money. While the exact amount of non-compliance is difficult to quantify due to a lack of reliable information, it has been estimated that the rate of non-compliance for the group to whom these rules apply, is approximately 70%, based on the data that Inland Revenue has been able to obtain. This figure includes people who should be accounting for tax under the FIF rules, as well as those transferring lump sums to New Zealand.

6. Public concerns with the current tax rules were identified in 2006 in submissions on the Taxation (Annual Rates, Savings Investment, and Miscellaneous Provisions) Bill. Submitters considered that the current rules relating to withdrawals from superannuation schemes should be clarified. Officials acknowledged that the tax implications arising from an exemption from the FIF rules were not clear and recommended that further work be undertaken (subject to other Government tax policy priorities). In November 2011, the Minister of Revenue announced a policy review of the taxation of foreign superannuation. An issues paper was released in July 2012[3].

7. The status quo is unsustainable as non-compliance would remain prevalent, which would be inconsistent with Inland Revenue's focus on encouraging voluntary compliance. As noted above non-compliance is estimated to be approximately 70%. This could also pose a risk to the Government's revenue if the tax is not collected. Inland Revenue would also be obliged to resume compliance (i.e. pre-audit) activity on people who have not paid tax with respect to past transfers. The expected imposition of use-of-money interest and late payment penalties may place individuals in financial difficulty.

8. The problem addressed in this statement is whether the current tax treatment of interests in – and lump sum receipts from – foreign superannuation schemes is appropriate and, if not, how it should be changed. As taxation is imposed by legislation, only legislative amendments are sufficient to address these concerns.

[3] *Taxation of foreign superannuation - an officials' issues paper*

OBJECTIVES

9. The objectives are to establish a coherent set of rules for the taxation of foreign superannuation held by New Zealand residents which have the following characteristics:

- *Equity* – to ensure that the tax treatment does not differ significantly based on a person's individual circumstances, such as whether they have foreign or domestic superannuation assets, or whether the income is received as a lump sum or a pension. For example, domestic savings are taxed on accrual and are exempt on withdrawal.

- *Efficiency* – to not discourage people from migrating to New Zealand or from transferring their superannuation here.

- *Simplicity* – to make the new rules as simple and compliance-friendly as possible, without the complexity that is prevalent in the current framework. This will help to reduce instances of non-compliance.

- *Certainty* – to enable people to determine their expected New Zealand tax liability in advance of transfer or migration, so that they are able to make informed decisions.

REGULATORY IMPACT ANALYSIS

10. To address the concerns regarding tax rules for foreign superannuation, officials identified the following options:

- **Option 1** – extend the accrual regime so that all interests in foreign superannuation schemes are taxed on accrual under the FIF rules. This would require repealing the existing FIF exemptions.

- **Option 2 –** tax all foreign superannuation on a receipts basis (i.e. when the income is received), in a manner which approximates tax payable on accrual. This would apply to both lump sums and pensions.

- **Option 3 (preferred) –** tax lump-sum withdrawals and transfers as per option two, but retain the current tax treatment for pensions[4]. This is, in essence, a hybrid of option two and the existing rules.

11. Retaining the status quo was not an option under explicit consideration. The inequity, complexity and lack of cohesion inherent in the current rules make them both undesirable and unsustainable.

12. The preferred approach is option three, which consists of taxing lump-sum withdrawals and transfers under the inclusion approach, and pensions under the current rules. The inclusion approach taxes lump sums on receipt and approximates the tax that would have been paid on accrual. The mechanics of the inclusion approach are discussed in paragraph 17. This is the framework presented in the officials' issues paper but with some modifications,

[4] Pensions are taxed on receipt at a person's marginal tax rate.

following the consultation process. Officials consider that this option best addresses the concerns with the current law and is consistent with the stated objectives.

13. The new rules will apply to New Zealand residents who hold interests in foreign superannuation schemes. This group is expected to comprise new migrants and returning New Zealanders who have worked or earned income overseas. In addition, the transitional rules will affect people who transferred or withdrew their foreign superannuation in a prior year and did not properly comply with their tax obligations in respect of that amount. Again, the group of people who have transferred or withdrew their foreign superannuation in a prior year are likely to have worked or earned income overseas.

14. The economic and social implications of the options are outlined in a table on pages 9-11. There are expected to be some compliance cost savings arising from the preferred option, with few administration costs likely. No environmental or cultural costs are expected to arise.

Analysis of options

15. Option one would extend accrual taxation by requiring all interests held by New Zealand residents in foreign superannuation schemes to be taxed under the FIF rules. To ensure this outcome, the FIF exemptions would cease to apply to foreign superannuation and several exemptions would accordingly be repealed. The current FIF methods, as discussed on page three, would continue to apply in the same manner. Any income received from the foreign scheme would not be taxable.

16. The main difference from the status quo is that some foreign superannuation income which is (or should be under the current law), taxable on receipt – pensions in particular – would cease to be and would instead be taxed annually on accrual. Typically, this would alter the amount of tax payable. As illustrated in the table on page three, the tax treatment of FIF and non-FIF treatment can differ significantly, and determining whether an interest falls under the FIF rules or not can be complex. Option one would remove these problems.

17. Option two would also apply accrual taxation to all foreign superannuation (both lump sums and pensions), but instead of this being payable annually under the FIF rules it would be accumulated and payable only on receipt. An interest factor would be incorporated into the calculations to account for the use-of-money benefit that a person receives by not paying tax annually. The eventual tax liability would, therefore, be a function of the length of time that the person holds the interest (as a New Zealand resident) before the income is received. A longer duration implies a greater deferral benefit. This is termed the "inclusion approach", as a portion of the income – calculated as above – would be included in a person's assessable income and the rest would not be taxable.

18. For this option, there are two main differences from the status quo. First, all foreign superannuation interests which are currently taxable under the FIF rules would be excluded from those rules. People would instead be required to return income when the amounts are received. Second, for income which is currently taxed on receipt (especially pensions), the amount of the tax liability would be expected to change. In most cases, except for lump sum amounts which are wholly or largely considered a return of capital, this option would reduce the tax payable.

19. Officials note that some submissions on the issues paper effectively argued for this option: that option three, which was proposed in the issues paper, should be extended to periodic pensions as well. This is not preferred, for reasons which are outlined in the table on pages 9-11.

20. Option three involves the application of option two only to lump-sum withdrawals and transfers, and retaining the current treatment of periodic pensions. The inclusion approach would be applied to lump sums received from foreign superannuation schemes. The inclusion rates will be calculated in the same manner as under option two. It is officials' preferred approach because it removes the complexity of the FIF rules, as well as the cash-flow problems that may arise when individuals have tax to pay on accrual but cannot access the required funds because their scheme is locked. It is also preferred because it recognises that the current tax treatment of periodic pensions is not a problem and therefore will continue to be taxed on receipt at a personal's marginal rate. The officials' issues paper proposed this option. A number of changes have been made following the consultation process (in particular, an alternative method to the inclusion approach to tax actual investment gains), although these do not affect the basic framework of this option.

21. There are some common advantages to all three options. In particular:

- The distinction between foreign superannuation interests that are subject to the FIF rules and those that are not will be removed. Less reliance will be placed on the current FIF exemptions, which can be subjective and difficult to apply. The tax consequences will no longer depend on whether, for example, a scheme is locked-in. This ensures that the rules are simple, fair, efficient, and provide certainty.

- Systematic over-taxation should be avoided by tax being payable to the extent that it would have been paid on accrual (plus an interest factor for the deferral benefit). Full taxation of lump sums, which has the potential to occur under the current rules, was not considered as a viable option. This ensures that the rules are fair.

- The taxation of lump sums will no longer be assessed under the existing rules that apply where there is a FIF exemption. The rules that apply where there is a FIF exemption are highly complex and depend on factors such as whether the distribution is from a company or a trust. This ensures that the rules are simple, which means that it will be easier to apply and less-information intensive for individuals.

- There will not be a disincentive to transfer superannuation to New Zealand compared to leaving savings overseas. This will achieve the objective of efficiency as a neutral policy setting is desirable.

22. The new rules will be implemented within the existing legislative and regulatory framework. A number of provisions have specific relevance to this policy reform. The transitional residents' rules provide an exemption from New Zealand tax (including both the FIF rules and tax on receipt) for most sources of foreign income during the first four or so years of residence. The agreement on trans-Tasman portability of superannuation between New Zealand and Australia will, when it comes into force on 1 July 2013, ensure that

qualifying transfers from certain Australian schemes into KiwiSaver schemes are not taxable. The 2010 double tax agreement between New Zealand and Australia also provides a similar result for lump sums.

23. The preferred option incorporates the existing measures described in paragraph 22. For example, transitional residents receiving lump sums will only be taxed on investment gains that would accrue after the end of their four-year exemption for foreign income. As transfers from Australia are exempt under the above international agreements, the preferred option addresses a revenue risk by providing for tax to be payable on foreign superannuation transfers into either New Zealand or Australian schemes.

24. Several key assumptions underpin these options. The amount of accrued gains and the use-of-money interest charge which are to be payable on receipt, use interest and growth rates of 5%. It is further assumed that the investment gains that accrue in the foreign scheme are not taxed (i.e. the foreign country operates an "EET" regime). These assumptions enable the calculation methods to determine the extent of tax that has not been paid in New Zealand on accrual (as under the FIF rules), which forms the basis for the new rules.

25. Officials consider these assumptions are robust. The 5% rates were chosen to be consistent with the FDR method, and will effectively serve as a cap where investment gains would be higher. (If investment gains are lower, the alternative approach for taxing actual gains may be used instead.) The assumption of an EET regime is valid as the majority of the source countries from which new migrants come, operate an EET regime. The notable exception is Australia; however, transfers of superannuation from Australia will not be taxable under the international agreements discussed in paragraph 22.

26. The fiscal implications of the preferred approach are very difficult to quantify due to a lack of reliable information, but have been estimated to be broadly fiscally neutral. The existing policy is to tax foreign superannuation, and the new rules are simply designed to make the rules easier to comply with rather than to collect any additional revenue.

27. In addition to the advantages listed above, which are common to all three options, officials' analysis is summarised in the following tables. Some terms are explained on page three:

Option	Advantages	Disadvantages	Net impact
One: Extend the accrual regime so that all interests in foreign superannuation schemes are taxed under the FIF rules. **Objectives met:** • Equity (partially) • Efficiency • Certainty	• The FIF exemptions would no longer apply, which would reduce some complexity, and subjectivity (certainty and to an extent simplicity). • Consistent tax treatment between lump sums and pensions (equity). • Consistent with treatment of domestic superannuation and savings (on a "TTE" basis) (equity and efficiency). • Consistent with treatment of other foreign assets held by New Zealanders that are also taxed under FIF rules (equity and efficiency). • Regular collection of tax annually rather than sporadically on receipt (certainty).	• FIF rules may be complex and unintuitive, which leads to additional compliance costs and increases the risk of non-compliance. • Significant practical issues in applying the FIF rules. For example, an individual may encounter cash-flow difficulties when paying tax on accrual in respect of a locked-in scheme as they cannot access the required funds. Individuals with defined benefit schemes may not have access to the required information on the value of their scheme. • Mismatch of foreign tax paid with other countries, which can result in some economic double taxation (when New Zealand tax has been paid on accrual, no foreign tax credit will be available in New Zealand for foreign tax subsequently paid on receipt). • Inconsistent with taxation of domestic pensions and foreign social security pensions. • Sizeable fiscal cost of reducing tax on pensions; ambiguous fiscal implications for lump sums.	Not preferred as it retains significant complexity even though at face value it makes the FIF rules simpler by removing possible exemptions. There are significant practical issues with accrual taxation for people with interests in locked-in and defined benefit schemes, compared with the status quo. There may be cash-flow or valuation difficulties, as such schemes are currently taxed on receipt. Furthermore, it creates inequity between foreign and domestic periodic pensions. There is a continued risk of non-compliance.

Option	Advantages	Disadvantages	Net impact
Two: Tax all foreign superannuation on receipt in a manner which approximates FIF taxation. **Objectives met:** • Equity (partially) • Efficiency • Certainty	• Taxation on receipt is more consistent with people’s expectations (certainty). • Resolves practical issues with the FIF rules of liquidity, valuation and lack of information (simplicity, but only in respect of lump sums. See disadvantages). • Less complexity than the FIF rules, so reduced risk of non-compliance (simplicity, but only in respect of lump sums. See disadvtanges). • Consistent tax treatment between lump sums and pensions (equity). • Matching of foreign tax credits with other jurisdictions which helps to prevent double taxation (efficiency). • Preserves residence state’s right to tax under a number of New Zealand’s double tax agreements (efficiency). • Largely consistent with taxation of other foreign investment (as lump sum taxation approximates accrual), although tax imposed at different times (equity).	• Partial taxation of pensions is not consistent with people’s expectations and creates additional complexity compared with the status quo. • Inconsistent with taxation of domestic pensions and foreign social security pensions. • Risk of revenue loss if person moves overseas before receiving the lump sum, as tax would not be collected annually.	Not preferred as it does not meet the simplicity objective, because it creates additional complexity for periodic pensions. Compared to the status quo, it would impose a significant risk of revenue loss due to the partial taxation of pensions. Furthermore, it creates inequity between foreign and domestic periodic pensions.

Option	Advantages	Disadvantages	Net impact
Three: Tax lump sum amounts on receipt in a manner approximating accrual taxation (as per option two) and retain the current tax treatment for pensions. **Objectives met:** • Equity • Efficiency • Simplicity • Certainty	• Targets reform at problem area (lump sums and FIF rules). • Retains current tax treatment of pensions, which is intuitive, simple and well understood (simplicity and certainty). • Resolves practical issues with the FIF rules of liquidity, valuation and lack of information (simplicity). • Less complexity than the FIF rules, so reduced risk of non-compliance (simplicity). • Matching of foreign tax credits with other jurisdictions which helps to prevent double taxation (efficiency). • Preserves residence state's right to tax under a number of New Zealand's double tax agreements (efficiency). • Largely consistent with taxation of other foreign investment (as lump sum taxation approximates accrual), although tax imposed at different times (equity). • Consistent with taxation of domestic pensions and foreign social security pensions (equity).	• Inconsistent tax treatment between taxation of pensions and lump sums, which may create boundary issues (e.g. commutation of pensions). • Pensions will be fully taxable, and so may be taxed on capital amounts and gains derived while non-resident. • Risk of revenue loss if person moves overseas before receiving the lump sum as tax would not be collected annually.	Preferred option as it meets all four objectives. There is a small trade-off of equity (between lump sums and pensions) for simplicity and improved compliance. This inequity exists under the status quo as well. However, it retains equity between domestic and foreign pensions which the other two options do not achieve. On balance, the benefits outweigh the costs. It is an improvement on the status quo as the revenue from periodic pensions is maintained and compliance in respect of lump sums is expected to improve, regardless of the revenue risk identified in the disadvantages column.

CONSULTATION

28. In the first half of 2012, officials consulted with certain tax practitioners and the members of the financial services industry on problems with the current tax rules for foreign superannuation. Their views were incorporated into the policy design, particularly the application of the FIF exemptions and concerns about the taxation of lump sums *vis-à-vis* pensions. An issues paper, *Taxation of foreign superannuation*, was subsequently released by Inland Revenue and the Treasury in July 2012. Fifty-nine external submissions were received, and the main comments from submitters were as follows:

Issues and comments raised in submissions	Response
Support for taxation on receipt There was considerable support for taxing foreign superannuation on receipt, rather than on accrual, under the FIF rules. The proposals were considered pragmatic, and the main advantages were said to be clarity and simplicity.	N/A
Inclusion approach may over-tax The inclusion rates assume growth in the foreign scheme of 5% (after taxes and fees), which was considered to be unrealistic. This may result in over-taxation. Consequently, submitters argued there should be an alternative method whereby tax would be payable on actual investment gains.	An alternative method has been included in the new rules that will tax lump sum amounts on the actual investment gains derived in a foreign defined contribution scheme while the person is a New Zealand resident. An interest factor will be charged on these gains in recognition of the use-of-money benefit from deferral. The grace period, during which no New Zealand tax will be payable on lump sum transfers or withdrawals, has been lengthened from two years to four years. This will provide a longer tax-free window during which people can transfer to New Zealand, and will be consistent with the duration of the transitional residents' exemption. Rather than the inclusion rates being calculated on the basis of years of residence since migration, they will instead be calculated on years of residence since the end of the grace period, or transitional residents' exemption. Gains which accrue during the grace period or transitional residents' exemption will not, therefore, be taxed on receipt.
Application date The proposed general application date of 1 April 2011 was not favoured. Instead, a prospective application date was preferred, with most suggesting 1 April 2013 or 1 April 2014.	The application date has been deferred from 1 April 2011, as initially proposed, to 1 April 2014 in order to provide more certainty to individuals affected by the proposals. Previously, it was proposed that a person must have complied with the FIF rules for the 2011 tax year by the due date for that year in order to continue using the FIF rules. Given that the general application date has

	changed, the criteria for a person to be able to continue to use the FIF rules have also been modified to be less restrictive. The new rules provide that only people who file a tax return including FIF income or loss in respect of a foreign superannuation interest before the introduction of legislation may continue to use the FIF rules for that interest after 1 April 2014. This is not restricted to any particular tax year.
Implementation issue - Low cost option for past transfers As a concessionary measure, the paper proposed an option for people who transferred a lump sum in the past and who did not previously comply to apply a 15% inclusion rate. The majority of submitters argued that the 15% inclusion option for past transfers is unfair, as previous non-compliance was inadvertent. Submitters argued that there should be a full amnesty for transfers made in prior years so there is no further tax to pay.	A full amnesty is not recommended as it would create an unfair advantage for non-compliant people over people who have complied with the law and fulfilled any resulting tax obligations. The 15% inclusion option is necessary to reduce potential tax liabilities facing people who did not comply with the tax rules in respect of past transfers. It does not impose taxation retrospectively The eligibility period for the 15% inclusion option has been extended to also apply to transfers up to 31 March 2014, as proposed in some submissions. In the absence of the 15% inclusion option, Inland Revenue's compliance (i.e. pre-audit) activity – which has been deferred pending this policy review – would recommence. The application of existing law, plus use-of-money interest and late payment penalties, would be expected to result in significantly higher tax burdens for most people. The 15% inclusion option is therefore a concessionary and voluntary alternative to the existing law.

29. The new rules have been developed in consultation with the Treasury. Inland Revenue has also consulted with the Ministry of Social Development and the Ministry of Business, Innovation and Employment.

CONCLUSIONS AND RECOMMENDATIONS

30. Officials have assessed the three options discussed in this Regulatory Impact Statement against the stated objectives. The recommended approach, option three, would establish a new, cohesive set of rules in the Income Tax Act 2007 to replace the current rules applying to interests in – and income from – foreign superannuation schemes. The FIF rules will cease to apply to foreign superannuation interests. Instead, lump sum amounts will be taxed on receipt under one of two new calculation methods. These methods are designed to approximate the tax that would have been paid on accrual under the FIF rules, in conjunction with an interest charge that recognises the deferred payment of tax until receipt. Foreign pensions will continue to be taxable on receipt at a person's marginal tax rate. On balance, the recommended approach achieves all four objectives for taxing interests in foreign superannuation: equity, efficiency, simplicity, and certainty.

IMPLEMENTATION

31. The new rules will apply to lump sum transfers or withdrawals received from a foreign superannuation scheme on or after 1 April 2014. New rules will also apply to transfers made before that date, which will be optional and operate alongside the existing law.

32. A person who receives a lump sum after 1 April 2014 will be required to determine the corresponding amount of assessable income under one of the two calculation methods. The result will be included in the person's income tax return for the tax year in which the lump sum was received.

33. A person who received a lump sum in a prior year, and for which they did not comply with their tax obligations (either under the FIF rules or on receipt) may either apply the law which existed at the time or include 15% of the lump sum in their assessable income. To use the 15% inclusion rate, a person will need to return the income in a tax return on or before 31 March 2016. Where the 15% inclusion rate is used, use-of-money interest and late payment and filing penalties will generally not be applied.

34. There will be transitional provisions in place with regards to the application of the FIF rules. A person will need to self-assess whether they can continue to use the FIF rules after 1 April 2014 according to specified criteria. If they are able to continue to use the FIF rules, they can elect to do so by including their FIF income or loss from a foreign superannuation interest in their income tax returns until their rights in the foreign scheme cease. Alternatively, the person can elect to apply the new rules rather than the FIF rules by not including the FIF income or loss in their tax return. Once this election is made, the person will not be able to subsequently apply the FIF rules in respect of that interest. Any income received from that interest will be taxable on receipt.

35. More guidance on implementation and transition issues will be provided when the new rules have been finalised, closer to the enactment of the amending legislation, for example in a Tax Information Bulletin. There are no significant administrative issues arising from these changes.

MONITORING, EVALUATION AND REVIEW

36. Inland Revenue monitors, evaluates and reviews new legislation under the Generic Tax Policy Process (GTPP). The GTPP is a multi-stage tax policy process that has been used for tax policy in New Zealand since 1995. The implementation and review stage of the GTPP involves reviewing the legislation after implementation and identifying any remedial issues.

37. The levels of voluntary compliance in relation to past transfers of foreign superannuation will be assessed through the uptake of, for example, the 15% inclusion option before 31 March 2016.

38. The effectiveness of the new rules after 1 April 2014 will be monitored under the GTPP. Any further changes that are identified as being necessary for the new legislation to have its intended effect would generally be added to the tax policy work programme, and those proposals would also go through the GTPP. Further consultation would be implicit in this

approach. Extending the new rules to foreign life insurance policies with savings elements, which share a number of characteristics with foreign superannuation, may be considered by officials at a later date.