Tax Issues for Individuals Immigrating to New Zealand

The following apply to all individuals moving to New Zealand. **HOWEVER** there are special exemptions for individuals who shift to New Zealand and have not been a New Zealand tax resident in the previous 10 years (including persons who had previously been a NZ tax resident.)

1. Understand when you become a New Zealand tax resident – **this is absolutely crucial**.

   You will become becomes a New Zealand tax resident (i.e. liable to pay New Zealand tax on your worldwide income) if:

   Either a) You are in New Zealand for more than 183 days **in any** 12-month period; or

   b) You have a "permanent place of abode" in New Zealand.

   The permanent place of abode test is very complex. Generally, the test focuses on the person having a home available to them in New Zealand and it does not matter if that home is owned or rented.

   You can be tax resident of more than one country. However, if you are moving to New Zealand from a country that has a double tax agreement (DTA) with New Zealand, then the DTA will generally treat you as being solely tax resident in whichever country that you have the closest connection to*. However, if you are a US citizen the US-NZ DTA will not treat you as being solely NZ resident in any circumstances.*

   Trap 1
   Time spent in New Zealand before moving here count in the 183-day test as discussed above. For example:

   Peter came to New Zealand on holiday for a month on the 1st of February 2019. He liked New Zealand and decided to shift here permanently. Peter went back overseas on 1st of March 2019 to sort out his affairs and shifted back to New Zealand permanently in July 2019.

   As Peter spent more than 183 days in New Zealand for the 12-month period beginning 1 February 2019 he is deemed to be a New Zealand tax resident from 1 February 2019.

   This means that any income Peter earned overseas in the period 1 February 2019 *might* be liable to New Zealand tax. *This is subject to operation of a DTA and the transitional residency rules discussed later*.

   Trap 2
   Residency for immigration purposes is **not** the same as tax residency. You are likely to be a tax resident long before you are a New Zealand citizen or permanent resident.

   Trap 3
   If you live in a country with which NZ does not have a DTA and you own a house in NZ that you use personally from time to time, you are very likely to be a NZ tax resident. The answer will generally be different if you are a tax resident in a country that NZ has a DTA with.

   Trap 4
   If you are a NZ tax resident and you move overseas and rent out your residential dwelling, you are likely to remain a NZ tax resident, especially if you eventually return to NZ and re-occupy your former dwelling. The answer may be different if you are going to a country that NZ has a DTA with.

2. If you have a trust overseas be aware that on shifting to New Zealand the trust (if you are deemed to be a settlor of the trust) will become liable for New Zealand tax as discussed below.

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If you do not elect, within 12 months becoming a New Zealand tax resident or ceasing to be a transitional resident (whichever occurs later), for the trust to become a complying trust then the trust will be classified as a non-complying trust.

Being a non-complying trust is highly undesirable as it means any distribution to a beneficiary of prior year income (including that earned while non-resident) or any capital gain will be taxed at a penal rate of 45%.

Electing to become a complying trust means the trust is liable to pay New Zealand tax on its worldwide income.

3. Most superannuation/pension/annuity payments received from overseas are taxable in New Zealand, even if they would have been tax free in your country of origin.

   Therefore, where possible you may want to consider cashing up your super fund/annuity and bring the capital to New Zealand.

   From 1 April 2010 there is an exemption from NZ tax for Australian pensions/super funds if the pension would have been tax free in Australia.

4. Since 1 April 2014, virtually all lump sum withdrawals from a foreign superannuation scheme by a person tax resident in New Zealand at the time are taxable in NZ. A foreign superannuation scheme is a scheme mainly formed for the purposes of retirement savings. If there is a penalty for removal of funds before retirement age, the Inland Revenue considers it is a foreign superannuation scheme.

   Transfers from Australia are exempt from these rules as New Zealand and Australia have a process in place for the transfer of retirement savings between the two countries.

   These rules also apply where pension funds are transferred to a New Zealand or Australian pension type scheme. They do not apply for transfers between pension schemes in other countries.

   The taxable income for withdrawals or transfers is calculated on a graduated scale based on the length of time you have been in NZ.

   NB – Transitional residents still get a 4-year exemption as discussed later.

5. If you have any life insurance policies overseas which you continue to contribute to while being a New Zealand tax resident the annual increase in the surrender value of the life policy is taxable in New Zealand – there is a limited exemption for new residents.

6. If you were previously a New Zealand tax resident but became non-resident and then become a New Zealand tax resident again with 5 years, be very careful if you have received a distribution from a trust.

7. New Zealand foreign investment fund (FIF) or Controlled Foreign Company (CFC) rules apply to most ownership interest that a NZ tax resident has in a foreign company, except for certain entities liable for tax in Australia. For NZ purposes, the definition of an overseas company will include entities like limited partnerships and incorporated entities that are not taxed as a company in the country of incorporation.

   When you become a New Zealand tax resident any FIF interests held are valued initially at market value on the day you arrive in New Zealand.

   Tax on any FIF investment is generally based on 5% of market value at the start of each year.

8. If New Zealand has a double tax agreement with your country of origin, it is important to understand the implications. This will be crucial to determine your tax residence and which country has the first or sole right to tax certain items.

9. New Zealand generally allows a credit for <u>income tax</u> paid overseas but only up to the extent of New Zealand tax on the overseas income.

   A credit for tax paid overseas will not be allowed if the DTA provides that the overseas country is not able to tax the income e.g. UK pension. In those situations, the tax paid overseas needs to be refunded from the other country's tax administrator.

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If you have overseas income that is subject to overseas income tax and are in a loss situation in New Zealand (because say, you are developing a vineyard) you will effectively be subject to double tax if the loss is derived in your personal name.

10. Any employment related payments received from overseas once you are a New Zealand tax resident are liable for tax in New Zealand.

11. Exchange gains on any bank deposits etc held overseas are taxable in New Zealand on either an accrual basis for taxpayers with more than $1m of investments or on maturity for taxpayers with under $1m of investments.

    Exchange losses may not be deductible unless the taxpayer is in the business of investing.

12. If you have an existing Trust that has accrued income or capital gains, consider realising these before shifting to New Zealand. They can then be injected as corpus into a new trust. Corpus can always be withdrawn tax free, no matter how the Trust is classified. **BUT** watch the ordering rules. These generally deem any distribution to come from taxable sources before capital and corpus.

13. **Overseas Rental Properties**
    If you own a rental property overseas **<u>and</u>** have a mortgage from an overseas lender then:

    a) Any exchange gain on the mortgage is taxable but the corresponding exchange loss on the property probably won't be deductible.

       e.g. assume Joe owns a UK rental property which cost $250,000, 100% of which is financed.

       At the time Joe became a NZ tax resident the NZ/UK exchange rate was .38. It is now .42 and has been as high as .55.

       At the time Joe became NZ tax resident:

$250,000 equated to	$NZ 658,000
At an exchange rate of .55 it equates to	$NZ 455,000
At an exchange rate of .42 it equates to	$NZ 595.000

       At the present time Joe's cost in $NZ to repay the mortgage is $63,000 less than it was when he shifted to NZ. Joe is therefore deemed to have derived taxable income of $63,000.

       Worse, as Joe's exchange gain exceeds $40,000, he has to calculate and pay tax on the gain each year. At the time when the exchange rate was .55 Joe had derived a theoretical gain of $203,000 on which he should have paid tax.

       As the exchange rate drops, he then derives a tax-deductible loss.

    b) Non-Resident Withholding Tax has to be paid on the interest paid to the foreign bank, unless that bank has a branch in NZ.

    NB – The above is a very simplified summary of which is a very complex area of tax law. If you have an overseas rental property, get professional advice.

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Persons becoming New Zealand tax resident after 1 April 2006 (Transitional Residents)

From the 1 April 2006, people arriving to live in New Zealand may qualify for a temporary tax exemption on most of their foreign income. This temporary tax exemption is available to those who arrive in New Zealand on or after 1 April 2006 and are new migrants or are returning to New Zealand and have not been resident for tax purposes in New Zealand for at least 10 years before their arrival in New Zealand.

The exemption can only be granted once in a lifetime.

The temporary tax exemption for foreign income lasts for four calendar years (up to 49 months). The exemption starts on the first calendar day of the month the person becomes New Zealand resident under the 183 day or permanent place of abode tests (discussed above) and is valid until the last calendar day of that month four years later.

The "tie-breakers" that determine residency under a DTA are ignored in determining the start of a transitional residency period.

For example:

Gabrielle arrived in New Zealand on 22 April 2016 and has one or more types of foreign income that are temporarily exempt from taxation in New Zealand (see list below). Gabrielle is eligible for the exemption from 1 April 2016 until 30 April 2020 which is effectively 49 months.

Types of foreign income temporarily exempt from tax in New Zealand:

Dividends
Interest
Bonuses or similar payments relating to employment performed from a previous job overseas, if the payment relates to services provided before becoming resident (even if received after arriving in New Zealand).
Controlled foreign company (CFC) income – under New Zealand's CFC rules
Foreign Investment Fund (FIF) income, including foreign superannuation under New Zealand's FIF rules
Non-resident withholding tax on foreign mortgages
Approved issuer levies on foreign mortgages
Taxation arising from employee share options
Accrual income from foreign financial arrangements
Certain trust income
Rental income derived offshore
Royalties derived offshore
Gains on sale of property derived offshore
Offshore business income (from a business owned personally) that is not related to the performance of services.

Once the tax exemption ends – after four years (up to 49 months) – the person must declare all foreign income on his or her annual income tax return.

These types of foreign income **are not tax exempt** in New Zealand:
Income derived from overseas employment performed while receiving the exemption
Business income relating to personal services performed offshore.
Directors fees/salaries from an overseas company will not qualify for the exemption as they are classified as personal services income.

Persons who may not want to apply for the Exemption

The person and the person's partner cannot receive family assistance while tax exempt from foreign income, so they should determine which option is better for them personally. For example:

a) *Gabrielle and her partner receive $1,000 worth of foreign interest per year but are eligible for family assistance of $5,000 per year in New Zealand if they do not claim the exemption for foreign income.* In this situation, it is in their best interests to waive the exemption, pay New Zealand tax on the foreign interest and receive family assistance.

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b) *Persons who have offshore rental properties which are in a tax loss situation may also not want to claim the 4-year exemption – no longer applicable for losses incurred from 1 April 2019 on, as such losses cannot be offset against other income.*

Trusts

Where a person is subject to the transitional residency exemption and they are settlers of a trust that was formed before they became resident in New Zealand, the trust is not subject to the New Zealand trust rules until after the expiry of the transitional residency period.

Foreign superannuation

As mentioned above there is a four-year exemption for lump sum withdrawals and transfers from foreign superannuation schemes. This exemption is separate to the transitional residency exemption.

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International Tax – Top 10 Tax Misconceptions for Individuals – as published by the IRD

International tax compliance can be complex and difficult. To help you get it right, the IRD have compiled the following list of commonly misunderstood tax facts relating to individuals:

1. New Zealand residents aren't just taxed on the income they earn in New Zealand, they are also taxed on their worldwide income.

2. If you leave the country but maintain a permanent place of abode here, you may still be a New Zealand resident for tax purposes, although this may be overridden by a Double Tax Agreement.

3. Foreign income including investments (even if deposited in an offshore account or left on a foreign credit card) is taxable in New Zealand even if it's not repatriated to New Zealand.

4. Equally, the fact that withholding tax may have been deducted on foreign income does not mean that this income is no longer taxable in New Zealand.

5. A foreign tax credit may be available but only where the tax involved is not subsequently refunded (even in a later income year), it is substantially similar to income tax and cannot exceed the tax otherwise payable on the underlying income in New Zealand.

6. Most overseas pension payments are now fully taxable in New Zealand.

7. Special taxing regimes (controlled foreign company and foreign investment fund rules) apply to gains on certain foreign shareholdings, retirement schemes and life insurance investments.

8. Additional disclosures are required in respect of controlled foreign companies and foreign investment funds.

9. Allowances that may be treated as tax-free in other countries (for example, living-away-from-home allowances) are generally fully taxable in New Zealand.

10. The temporary tax exemption on foreign income for transitional residents expires after 48 months and there is no entitlement to Working for Families Tax Credits during the period of the exemption.

Source – IRD website

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