Tax Issues for Non Residents

The following notes apply to all persons moving to New Zealand. **HOWEVER** there are a number of special exemptions for persons who shift to New Zealand and have not been a New Zealand tax resident in the previous 10 years. (This includes persons who had previously been a NZ tax resident.) See Paragraph 4.

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

Basically you are a New Zealand tax resident (i.e. liable to pay New Zealand tax on your world wide 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. This does not mean that owning a house in New Zealand makes you a tax resident, although it is now the dominant factor the IRD consider. We note however the IRD view is not supported by case law.

Trap 1

If you come to New Zealand on holiday, on say 1 February 2003, like New Zealand and decide to shift here, go back overseas on 1 March 2003 to sort out your affairs and shift back to New Zealand permanently any time before 29 August 2003 you will be deemed to be a New Zealand tax resident from 1 February 2003.

This means that any income earned overseas in the period 1 February 2003 to the date you arrive back in New Zealand will be liable to New Zealand tax.

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.

Trap 3

If you live in a country with which NZ does not have a Double Tax Treaty and you own a house in NZ the IRD are far more likely to try and treat you as a NZ tax resident.

Trap 4

If you go overseas and rent out your residential dwelling the IRD are more likely to try and argue that you remain a NZ tax resident.

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 be liable for New Zealand tax.

   Unless you elect, within 12 months of becoming a New Zealand tax resident, for the trust to become a complying trust then the trust will be classified as a non complying trust.

   This 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 world wide 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.

   As far as possible you should cash up your super fund/annuity and bring the capital to New Zealand.

   As 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. As from 1 April 2014 virtually all lump sum overseas pensions are taxable in NZ, on a graduated scale based on the length of time you have been in NZ.

   NB – Transitional residents still get a 4 year exemption – see Page 3 to 4.

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) rules tax any interest in a foreign entity, except for certain entities liable for tax in Australia.

   When you become 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. For gifts made after 1 October 2011 gift duty is no longer payable.

9. If New Zealand has a **double tax agreement** with your country of origin, **read it**. This will be crucial to determine your tax residence.

10. New Zealand generally allows a credit for income tax 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.

    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.

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

12. 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.

13. If you have an existing Trust that has accrued income or capital gains, consider realizing 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.

14. **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 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.

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 returning New Zealand who 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 arrives in New Zealand and is valid until the last calendar day of that month four years later.

For example:

Gabrielle arrives in New Zealand on 22 April 2006 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 2006 until 30 April 2010 which is effectively 49 months.

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

- Dividends
- Interest
- Bonuses from a previous job overseas, even if received after arriving in New Zealand
  N.B. If you come to New Zealand, return overseas and come back to New Zealand and receive income from employment while overseas that employment income may still be taxable 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.

b) *Persons who have offshore rental properties which are in a tax loss situation may also not want to claim the 4 year exemption.*

International Tax – Top 10 Tax Misconceptions for Individuals – as per 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.