i-Select Superannuation Scheme

i-Select PIE Superannuation Scheme

Tax Summary for Australian Residents - August 2019

Introduction

The i-Select Superannuation Scheme (**i-Select Scheme**) and the i-Select PIE Superannuation Scheme (**i-Select PIE Scheme**, together **the i-Select Schemes**) are registered in New Zealand as superannuation schemes under the Financial Markets Conduct Act 2013. This document gives general guidance on the taxation of the i-Select Schemes, the tax treatment of UK pension transfers and distributions paid by the i-Select Schemes for Australian resident Members.

For tax purposes, the i-Select Schemes are domiciled in New Zealand and are subject to the Income Tax Act 2007. As Qualifying Recognised Overseas Pension Schemes (**QROPS**) they are eligible to accept QROPS transfers from UK pension schemes. Scheme Members resident in New Zealand are subject to the Income Tax Act 2007. Scheme Members resident in Australia are subject to the Australian Income Tax Assessment Act 1997 as overridden by the Australian/New Zealand Double Taxation Agreement (**DTA**).

The information in this document is only intended to provide general guidance on New Zealand and Australian income tax law as it relates to Australian Members of the i-Select Schemes and is an indication of the relevant legislation in effect as at the date of this document. The document also gives general guidance on UK taxation of UK pensions transferred to the i-Select Schemes. The application of tax law is fact specific. Investors should seek professional tax advice particular to their individual circumstances (including their foreign tax position) prior to investing in either i-Select Scheme so that they clearly understand the taxation implications of such an investment. Neither i-Select, nor the Supervisor, nor any other person accepts any responsibility for the taxation consequences of the investor's decision to invest in either i-Select Scheme.

Summary

Australian's investing into New Zealand domiciled superannuation schemes, such as the i-Select Schemes, are taxed under the Australian Income Tax Assessment Act 1997 as amended by the DTA with New Zealand.

Australia does not have a Foreign Investment Fund regime, and so it does not tax the income or growth arising within an offshore superannuation scheme until it is realised in Australia.

Neither does Australia tax the transfer of one foreign superannuation scheme fund to another foreign superannuation scheme.

Whilst a payment from a foreign superannuation fund to an Australian resident Member would generally attract a tax liability in Australia, under the Australian DTA with New Zealand an Australian Member taking benefits from a New Zealand superannuation scheme pays no more tax than a New Zealand resident would pay, and a New Zealand resident pays no tax on distributions from registered New Zealand superannuation funds.

Under the DTA, relief from Australian income tax is in principle available where:

- Lump Sums: The payments are made under a retirement benefit Scheme, in which case they are only taxable in New Zealand, and New Zealand does not tax them; or
- Periodic Payments: The payments are subject to no more tax in Australia than they would if they were paid in New Zealand, and New Zealand does not tax them.

Consideration needs to be given to the Australian general anti-avoidance rules which could potentially apply where the New Zealand superannuation scheme generates a tax benefit and the scheme has been entered into for the dominant purpose of obtaining the tax benefit. However, where there are regulatory or commercial features or drivers that support the position that securing a tax benefit is not the dominant purpose of joining the scheme, there is an argument that the general anti-avoidance provisions should not apply. This argument may be strengthened by the fact that the Member's actions are driven by, amongst other things, UK tax and regulatory considerations.

Double Tax Agreement

Ordinarily, a superannuation payment arising through a New Zealand superannuation scheme made to an Australian resident Member would be treated as if it were received from a non-compliant fund and would attract an Australian tax liability. However, in respect of pensions and annuities and other ongoing superannuation payments, Article 18(1) of the Australian New Zealand DTA provides that:

> Pensions (including government pensions) and other similar periodic remuneration paid to a resident of a Contracting State [Australia] shall be taxable only in that State [Australia]. However, such income arising in the other Contracting State [New Zealand] …. shall not be taxed in the first-mentioned State [Australia] to the extent that such income would not be subject to tax in the other State [New Zealand] if the recipient were a resident of other State [New Zealand].

In addition, in respect of lump sum retirement benefits, Article 18(2) of the DTA provides that:

> Lump sums arising in a Contracting State [New Zealand] and paid to a resident in the other Contracting State [Australia] under a retirement benefit scheme, or in consequence of retirement, invalidity, disability or death, or by way of compensation for injuries, shall be taxable only in the first-mentioned State [New Zealand].

New Zealand does not tax the payments made from registered superannuation schemes, regardless of whether they are in the form of lump sums or regular payments, so they are not taxable on Australian residents either.

Superannuation Taxation

Basis of New Zealand Taxation
New Zealand taxes only New Zealand residents on the transfer of UK and other offshore pension funds to New Zealand superannuation schemes. It does not grant tax relief on contributions to superannuation schemes, and the schemes themselves pay tax on their income. It is for this reason that distributions from registered superannuation schemes are treated as 'tax paid' and are not subject to tax in the hands of a New Zealand resident.

UK or other foreign pension transfers
For an Australian resident, the transfer of a UK or other offshore superannuation fund to New Zealand is exempt from Australian and New Zealand taxation.

The transfer is exempt from Australian taxation under specific provisions of the Australian Income Tax Assessment Act 1997.

> INCOME TAX ASSESSMENT ACT 1997
>
> SECTION 305-70
>
> Lump sums received more than 6 months after Australian residency or termination of foreign employment etc.
>
> 305-70(4) Any part of the lump sum that is paid into another foreign superannuation fund is not assessable income and is not exempt income.

The ATO website confirms this at reference QC 17661 dated 25 May 2015 when it says that:

> "When a payment is made from one foreign super fund to another foreign super fund, there will be no tax payable by you as an Australian resident taxpayer at the time of that payment. Tax is deferred until the benefit is eventually paid to you or to an Australian super fund, or otherwise dealt with on your behalf (that is, the monies exit the foreign super environment)."

The transfer from a foreign superannuation scheme to a New Zealand scheme is also exempt from New Zealand tax because the Member is not resident in New Zealand. New Zealand's taxing provisions specifically apply only to New Zealand residents.

> INCOME TAX ACT 2007
>
> SECTION CF3 – WITHDRAWALS FROM FOREIGN SUPERANNUATION SCHEMES
> CF3 (1) WHEN THIS SECTION APPLIES
>
> This section applies when a New Zealand resident derives a benefit (a foreign superannuation withdrawal) that is not a pension or annuity and arises from an interest in a foreign superannuation scheme.

Scheme Income
All superannuation scheme income, other than certain employer contributions, is subject to tax. Income earned by the scheme is considered to be 'trustee income' and not taxable on the Member. Taxable income of the trustee is taxed at either 28%, in the case of a widely-held superannuation scheme, or 33% if it is not widely-held. Both i-Select Schemes are widely-held and qualify for the lower 28% rate of tax, and all income within the i-Select Superannuation Scheme is therefore taxed at 28%.

Where a superannuation scheme has elected for Portfolio Investment Entity (**PIE**) tax status, the income of the scheme is notionally attributed to Members and taxed by the scheme at the individual Members' Prescribed Investor Rate (**PIR**). This is the case provided the correct PIR is notified by the Member to the Scheme.

Additionally, where a scheme has elected to be a Foreign Income PIE, non-New Zealand tax resident Members of the Scheme can elect a PIR rate of 0% and will be taxed on their attributed foreign income within the Scheme at that rate.

The I-Select PIE Superannuation Scheme is structured as a Foreign Investment Variable Rate PIE (**FIVRP**), which allows Australian residents to nominate a 0% PIR as a Notified Foreign Investor (**NFI**).

Withdrawals from the Scheme
The DTA provides for Australian residents to be taxed to the same extent as New Zealand residents, so it is therefore important to know how New Zealand residents are taxed on payments from retirement savings schemes. As previously stated, a distribution from either i-Select Scheme would not be taxed on a New Zealand resident as it is treated as tax-paid income. This treatment would therefore extend to Australian residents, who would not be taxed on the distribution to them of retirement benefits from either i-Select Scheme.

Portfolio Investment Entity Status
The i-Select PIE Scheme has elected to become a PIE under the Income Tax Act 2007, and further elected to be a FIVRP.

Registration
The Schemes registration as a FIVRP was granted in June 2019, and the Scheme attributes income daily.

PIE Taxation
The tax treatment of investments in PIEs can be described as a combination of look-through and withholding.

A PIE has the obligation to:
- calculate its pre-tax income;
- attribute this to each of its Members in proportion to their interest in the PIE;

and,
- return income tax calculated on the aggregate of each Member's proportionate share of the pre-tax income multiplied by that Member's PIR.

The attribution of income earned by the PIE to its Members arises irrespective of whether the income is paid out or distributed to the Member in that income year.

Tax Rates for Members of the PIE
Under the PIE rules, while the i-Select PIE Scheme maintains FIVRP status, Members of the Scheme can elect to be taxed at the following rates - their Prescribed Investor Rate:

- Foreign investors
    - 0% (if they meet the Notified Foreign Investor Requirements, see below)
- New Zealand residents – at their margin tax rate either
    - 10.5%;
    - 17.5%; or
    - 28%

Tax is calculated daily and attributed monthly by the Scheme administrators, or on a Member making a withdrawal or transferring from the Scheme, and is paid through the redemption of units in the fund.

Notified Foreign Investor
For a Member, who is not New Zealand resident, to be treated as a Notified Foreign Investor (**NFI**) and to be taxed at a 0% rate on foreign income they must meet and maintain the following conditions:

- They must not be tax resident in New Zealand;
- They must provide their date of birth;
- They must provide a home address in their country or territory where they reside for tax Purposes;
- They must provide their tax file number or reference in the country or territory where they reside for tax purposes, or a declaration if they are unable to provide this number;
- State in the Scheme application that they wish to be treated as an NFI.

The i-Select PIE Superannuation Scheme gathers this information as part of the application process.

If a foreign investor does not notify the Scheme that they wish to be treated as an NFI then they will be taxed at the highest PIR rate of 28%.

New Zealand sourced income, if any, may be taxable at New Zealand's withholding rate of tax. For example, New Zealand interest would be taxed at 1.44%. Once a year, the Scheme will ask the Member to confirm their NFI details are still valid. This is done by the i-Select PIE Scheme as part of the annual tax statement process. If the Scheme receives no response the Scheme may continue to treat the client as an NFI.

UK Tax Requirements

QROPS requirements
As a QROPS the i-Select Schemes must comply with the UK Finance Act 2004 as it applies to QROPS, as overseen by Her Majesty's Revenue and Customs (**HMRC**).

Overseas Transfer Charge
Since March 9, 2017, if a Member is not tax resident in the country to which their pension is being transferred (and other exemptions do not apply), they will be subject to a 25% UK tax called the Overseas Transfer Charge (**OTC**). The conditions of any exemption from the OTC must also continue to apply for five clear and complete UK tax years after a Member's transfer. Any transfer from a UK pension fund to a New Zealand superannuation scheme will therefore be subject to the OTC for an Australian tax resident.

The OTC does not apply to transfers between QROPS where the original UK pension fund was transferred out of the UK prior to the introduction of the OTC on 9 March 2017. It would therefore not apply to a fund within the i-Select Superannuation Scheme that was transferred out of the UK before 9 March 2017 and which is transferred to the i-Select PIE Scheme.

If the OTC applies, and within the five-year time limit an exemption applies when it did not previously, the OTC will be refunded.

For any Member that is potentially subject to the OTC, they must tell the scheme manager about any change to their address or tax residency while they are a Member of the scheme.

Unauthorised withdrawals
HMRC will levy Member payment charges on withdrawals made from the Scheme that do not meet the UK tax rules applying to QROPS. When a Member makes an unauthorised withdrawal of their UK transfer amount an unauthorised Member payment charge of up to 55% will apply on the withdrawal. As a rule, the manager would refuse to allow non-complying payment to be made from the Scheme.

Member payment charges
The Member Payment Charges (**MPC**) may also apply where a Member has taken certain types of benefit from funds that originally derive from UK tax-relieved pension funds, and where they have been resident in the UK within a certain period of time, or if benefits are taken within 5 years of transfer.

The MPC does not apply to benefits:

- Taken under Flexi-Access;
- Outside of certain time limits referable to the date the UK pension fund was transferred out of the UK, the date the Member ceased to be UK resident, and the date benefits were taken relative to the date of transfer; and
- Where the Member is tax resident in a country which has sole taxing rights under a double taxation agreement with the UK.

Most benefits taken from the i-Select Schemes are taken as flexi-access, and Australia has a DTA with the UK that gives Australia sole taxing rights. The MPC is therefore unlikely to apply to Australian tax residents.

Lifetime Allowance
When transferring from a UK Registered Pension Scheme, any pension funds will be tested against the UK Lifetime Allowance. This test, which takes into account all pension benefits, tests to see if the total pension value is in excess of limits prescribed by HMRC. The current Lifetime Allowance limit is £1,055,000. Where the transfer amount is in excess of this amount, a tax charge of 25% is levied on the excess prior to transfer.

Transfer of some or all of the NZ superannuation fund to an Australian Superannuation Fund that is a QROPS.
The rules surrounding the transfer of foreign superannuation funds to Australia are very complex, and the summary below outlines the rules based on our understanding. Reliance should not be placed on this summary, and professional advice should be sought in every case.

Assuming:

- An Australian has reached the age of 55;
- The Australian is a member of an Australian superannuation fund that has registered with the UK tax authority, HMRC, as a QROPS;
- The Australian resident had a UK pension fund which had been transferred to an i-Select Scheme;
- The i-Select Scheme received income and capital gains in its growth phase;
- The Australian resident decides to transfer some or all their i-Select Scheme fund to their Australian superannuation fund;

It is possible that:

- None of the transferred amount will be assessable income of either the member or the fund.
- Some or all of the transferred amount will be treated as income of the Australian resident and taxable at their marginal rate of tax.
- Some or all of the transferred amount will be treated as income of the Australian superannuation scheme and taxed at 15%.
- Some or all of the transferred amount will be treated as excess contributions and taxable at the excess contribution tax rate of up to 47%.

To determine which of these circumstances apply depends upon a number of factors:

- The age of the Australian resident. This determines whether future years non-concessional cap amounts can be brought forward. Those over the age of 65 cannot bring forward future years caps. Those below the age of 65 can bring forward the cap from two future years;

- The Non-Concessional Contribution Cap. This is currently $100,000 per annum (those over 65 must be working to qualify) and there is a lifetime Total Superannuation Balance Limit, of $1.6 million.
- If the foreign superannuation fund is related to an employment with a foreign employer, whether or not that foreign employment ceased within 6 months of the transfer;
- The date that the Australian became resident in Australia.
- Either (whichever is applicable):
  - The value of the foreign superannuation fund at the time the Australian resident became resident in Australia; or
  - The value of the foreign superannuation fund at the time the Australian resident ceased to be employed by a foreign employer associated with the foreign superannuation scheme.
- The date the transfer is made;
- The transfer value;
- The amount of concessional contributions already made in Australia during the year in question;
- The amount of non-concessional contributions already made in Australia during the year in question;
- Whether any of the current year or future years non-concessional caps have already been utilised to cover any excess contributions in earlier years;
- Whether the amount transferred includes amounts that are Assessable Foreign Fund Amounts. These are amounts that are added to the fund at the time of transfer that the member would not normally be entitled to at that time if they were not transferring their fund;
- Whether the full entitlement of the member in the foreign superannuation fund is being transferred or only part of it;
- The marginal tax rate of the Australian resident (i.e. the top rate of tax of the Australian resident taking into account their existing assessable income);

Possible tax charges arise from:

- Applicable fund earnings
- Assessable fund amounts
- Excess contributions

Applicable fund earnings
If a foreign superannuation fund is transferred more than 6 months after Australian tax residence begins, or more than 6 months after a foreign employment (to which the foreign superannuation relates) ceases, the growth in value since residence started, or since the foreign employment ended (as applicable), is taxed as Applicable Fund Earnings.

Applicable fund earnings must be declared in a tax return and are taxed on an Australian resident at their marginal tax rate. If an Australian declares Applicable Fund earnings on their tax return, the amount assessed counts as a non-concessional contribution and will be tested against the non-concessional contribution cap.

Where the full amount of the foreign superannuation has been transferred, the tax liability arising on this deemed income may be transferred to the receiving Australian scheme, and the trustee will pay the tax at the rate of 15%. This is done by an election, and the election may be for some or all of the tax liability to be transferred. Where an Australian superannuation fund pays the tax in this way, the contributions are not treated as non-concessional contributions by the member, and are not tested against the non-concessional contribution cap.

Where only part of the foreign superannuation is transferred, it is not possible to elect for this tax liability to be transferred to the Australian superannuation fund. They will remain taxable on the Australian resident, and will continue to be tested against the non-concessional contribution cap. The wording of Section 305-70(2) of the Income Tax Assessment Act 1997 is such that the full amount of the amount calculated to be Applicable Fund Earnings is treated as received first:

> "Included in your assessable income so much of the lump sum … as equals: (a) your applicable fund earnings (worked out under section 305-75)"

Transferring between foreign superannuation schemes does not 'reset' the Applicable Fund Earnings to zero, as there is provision for account to be taken of any amount that would be Applicable Fund Earnings in any previous foreign superannuation scheme.

Assessable Fund Amounts
Where an amount is added to the foreign superannuation scheme just prior to the transfer and has only been added because of the transfer, then this is an Assessable Fund Amount.

Examples of Assessable Fund Amounts are additional discretionary contributions added by a former foreign employer in recognition of past service, or a share of an annual bonus that is normally added at the foreign scheme's financial year end, but which is being calculated in advance because of the transfer.

These amounts are taxed as part of the Australian superannuation fund's income, and tax is paid on these at 15%. Australian residents cannot elect to pay tax on these personally.

The amount assessable is not treated as a non-concessional contribution by the member, and does not therefore utilise any of the Australian's non-concessional contribution cap. However, they are treated as concessional contributions, and are counted towards the concessional contribution cap.

Excess contributions tax
Transfers of foreign superannuation funds to an Australian superannuation fund are generally treated as non-concessional contributions. If an Australian resident makes excess non-concessional contributions, they will be taxed at 49%.

The calculation to determine whether a transfer of a foreign superannuation fund (i.e. contributions) is within or exceeds the non-concessional contribution cap may be summarised as:

$$A + B – C – D + E – F$$

Where:

A is the concessional contribution cap
B is the brought forward concessional cap from the following two years
C is the amount of non-concessional contributions already made
D is the amount of the transfer
E is the amount of Applicable Fund Earnings taxed on the SMSF
F is the Assessable Fund Amount taxed on the Australian resident

If the amount from this calculation is positive, there are no excess contributions.

If the amount from this calculation is negative, there are excess contributions and they are taxable at 47% and may be taxed again when benefits are taken.

There are other strategies that may be adopted with regard to excess contributions, but these require careful consideration and it is highly recommended that personal tax advice is sought from a suitably qualified and experienced tax or financial adviser.

Double Taxation Agreement

The DTA that Australia has with New Zealand is unlikely to be of any assistance with a transfer of a superannuation fund from an i-Select Scheme to an Australian scheme. Article 18 of the DTA is worded in such a way that the clear inference is that its provisions relate to individuals, and not superannuation scheme trustees. A transfer between schemes is therefore not an amount "paid to a resident of [Australia] under a retirement benefit scheme" as required by the DTA.

Australian Anti Avoidance

Australia has general anti-avoidance provisions in Part IVA of the Income Tax Assessment Act 1936. If these rules apply, the Commissioner of Tax has the power to deny or cancel any Australian Members tax benefits associated with the Scheme.

For Part IVA to apply, the following must be present:

- There must be a scheme
- It must have been entered into after 27/05/81 (when Part IVA was introduced)
- There must be a tax benefit
- It must be possible to conclude that the scheme was entered into for the dominant purpose of obtaining a tax benefit from the scheme.

When Part IVA was enacted, the then Treasurer said of it:

- "arrangements of a normal business or family kind, including those of a tax planning nature", would be beyond its scope."

  and

- "Pt IVA is designed to operate against "blatant, artificial, or contrived arrangements, but not cast unnecessary inhibitions on normal commercial transactions by which taxpayers legitimately take advantage of opportunities available for the arrangement of their affairs".

Although the provision is written very widely, there may be a legitimate expectation that the ATO will only use the powers of Part IVA in cases that are blatant, artificial or contrived in nature, and not where opportunities present themselves in the normal course of events.

Part IVA may apply to "treaty shopping" schemes, which are schemes whereby an arrangement is structured in a manner that attracts a tax benefit under a Double Taxation Agreement that Australia has with another country or jurisdiction. Determination TD 2010/20 outlines the Commissioners view on this, and mainly provides examples of newly created interposed entities in an international network of companies and businesses in an artificial way in order to achieve a particularly contrived tax advantage.

The application of Part IVA is at odds with the legitimate use of an existing New Zealand superannuation scheme established for retirement saving that is used mainly by residents of New Zealand. Combined with this, Australians are, in many instances, unable to bring their UK retirement savings into Australia because of restrictions under the UK pension rules, the UK QROPS rules, or the Australian superannuation rules. Where there are such regulatory and commercial features or drivers that support the position that securing a tax benefit is not the dominant purpose of entering into the scheme, there is an argument that the general anti-avoidance provisions should not apply.

The ATO's may have an alternative view on the application of DTA relief and the application of the general anti-avoidance provisions to those expressed in this document. Advisers and Members should ensure that the dominant purpose for transferring a Members UK pension to the Scheme is not to benefit from the tax structure of the Scheme and should consider obtaining independent tax advice.

i-Select Limited
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