

Special report from the
Policy Advice Division of Inland Revenue

The new superannuation fund withdrawal tax

Introduction

The Taxation (FBT, SSCWT and Remedial Matters) Act introduced a fund withdrawal tax of 5 percent of an employer's contribution to an amount withdrawn from a superannuation fund under certain circumstances. The measure is intended to counter avoidance, through the use of superannuation funds, of the increase in the top personal tax rate, effective from 1 April 2000. The legislation mainly amends subpart 1 of the Income Tax Act 1994.

Background

The specified superannuation contribution withholding tax (SSCWT), set at 33 percent, is a tax on employers' monetary contributions to superannuation funds.

Increasing the top personal tax rate to 39 percent and leaving the SSCWT rate unchanged at 33 percent introduced scope for avoidance. Employees earning over \$60,000 could negotiate an increase in their employer superannuation contributions, subject to the 33 percent SSCWT rate, with a corresponding reduction in salary and wages subject to tax at 39 percent. They could withdraw the increased employer contributions shortly afterwards, thus avoiding the 39 percent top personal marginal tax rate.

The fund withdrawal tax is intended to remove this avoidance concern. It works by effectively applying a 5 percent tax on withdrawals which are not exempt. The principal exemptions are for cessation of employment, significant financial hardship, and for withdrawals by those earning under \$60,000.

These measures are intended to:

- minimise the compliance cost impact on employers, employees and superannuation funds given the need to address the avoidance issue.
- ensure that current contributions and already determined levels of future contributions will not be affected by the fund withdrawal tax.
- allow employees to substitute employer contributions to superannuation savings for salary thereby increasing their savings for their retirement without an avoidance concern being raised.

At 5 percent, the fund withdrawal tax should remove the tax benefit for those earning over \$60,000 from substituting employer contributions to a superannuation fund for salary and wages.

How the fund withdrawal tax will work

The legislation provides:

- For a withdrawal tax of 5 percent of the amount withdrawn from a superannuation fund in respect of a member under certain circumstances. This tax is restricted to the amount of the employer contribution on that member's behalf if the trustee can identify this.
- Existing contributions and contributions that continue at 1 April 2000 levels are not subject to the withdrawal tax.
- The tax on a withdrawal is payable in the following income year except in the case of a superannuation fund winding-up or leaving New Zealand. This measure is intended to address a number of provisional tax and use of money interest issues.
- For the withholding of the amount of the withdrawal tax from a payment to a member making a withdrawal, or the recovery of that amount from a member.
- Members and trustees may request from members, employers and other superannuation funds that information necessary to apply the withdrawal tax. Trustees may rely on the information provided as being correct unless there are reasonable grounds for the trustee to believe the information is not correct.

Withdrawal exemptions

- The withdrawal tax does not apply to funds that are withdrawn on, or shortly before, or after an employee ceases employment except in limited circumstances.
- It does not apply to withdrawals on the basis of significant financial hardship.
- It does not apply to withdrawals necessary to settle the division of matrimonial property.
- An exemption is provided for those earning less than \$60,000. If in any of the four income years preceding the year of a withdrawal a member's taxable income and employer specified superannuation contributions is less than \$60,000, the withdrawal tax is reduced by 25%. This means that if in all four years the \$60,000 threshold is not exceeded, no withdrawal tax applies at all.
- Withdrawals made on the basis of partial retirement are also exempt. Partial retirement occurs when:
 - the member works less than 30 hours per week;
 - has reduced working hours as a lead-in to full retirement;
 - provides written notification that he or she does not intend to increase hours in paid employment in the future;
 - the employer certifies that there is no understanding to increase work hours in the future; and
 - all employer and employee contributions to a superannuation fund cease.

- Withdrawals used to purchase a life annuity, or one to be paid over 10 or more years, are not subject to the withdrawal tax. The same provisions apply to pensions with those terms.
- Withdrawals to meet fund administration costs and the costs of group and individual life, health, sickness or accident insurance on behalf of members are exempt.

For the purposes of the Income Tax Act a superannuation fund is a superannuation scheme registered under the Superannuation Schemes Act 1989. Broadly, a superannuation scheme is:

- Any trust or unit trust established by its trust deed principally for the purpose of providing retirement benefits to beneficiaries who are natural persons; or
- Any company (not being a unit trust) that -
 - Is not resident in New Zealand; and
 - Has been established principally for the purpose of providing retirement benefits to members or relatives of members who are natural persons; or
- Any arrangement constituted under an Act of Parliament principally for the purpose of providing retirement benefits to natural persons other than the Social Security Act 1964 and any similar arrangement constituted under the legislation of a country outside New Zealand.

TREATMENT OF TRANSFERS TO OR FROM SUPERANNUATION FUNDS AND SUPERANNUATION SCHEMES

TRANSFERS ¹	To a superannuation fund	To a defined benefit superannuation fund	To a superannuation scheme	To a foreign superannuation scheme
From a superannuation fund				
• Supporting information provided	Transfers keep same nature as in transferring fund	Grandparented and employee contributions retain their nature ²	Withdrawal ⁴	Withdrawal ⁴
• Supporting information not provided	Treated as employer contributions to superannuation savings	CL 4 applies subject to exemption application ³	Withdrawal ⁴	Withdrawal ⁴
From a defined benefit superannuation fund				
• Supporting information provided	Transfers keep same nature as in transferring fund	Grandparented and employee contributions retain their nature	Withdrawal ⁴	Withdrawal ⁴
• Supporting information not provided	Treated as employer contributions to superannuation savings	CL 4 applies subject to exemption application ³	Withdrawal ⁴	Withdrawal ⁴

From a superannuation scheme	Treated as member contributions	Treated as member contributions	n/a ⁵	n/a ⁵
From a foreign superannuation scheme	Treated as member contributions	Treated as member contributions	n/a ⁵	n/a ⁵

- Note:**
- 1: Section CL 13 deems a transfer to be a withdrawal.
 - 2: "Retain their nature" is considered to mean that employer contributions received from a transferring fund continue to be treated, for example, as employer contributions.
 - 3: Not deemed to be employer contribution to superannuation saving as the rules for defined benefit fund rules work by taxing withdrawals other than those grandparented, exempt or made by members.
 - 4: No specific rules therefore transfer simply treated as withdrawal.
 - 5: The withdrawal tax only has impact on superannuation funds. Transfers between schemes do not enter the withdrawal tax base except to the extent that a scheme making a transfer was previously a superannuation fund in which case the superannuation fund rules apply.

Other features

- Employees may elect, with the approval of their employer, that a 39 percent SSCWT rate apply to specified superannuation contributions made by that employer on the employee's behalf. Only employees who earn over \$60,000 a year are likely to use this option.
- Employees may elect to apply the optional 39 percent SSCWT rate from 1 October 2000.

Application date

The application date of the grandparenting provisions is 1 April 2000. The withdrawal tax rules themselves apply from 14 September 2000. The option to elect a 39% SSCWT rate applies from 1 October 2000.