Guide for Kiwi's Returning Home

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Welcome home -
for whatever reason you chose to return.

In this whitepaper we set out for you the taxation implications that you will need to consider both in New Zealand and in the country that you have come from when you make the decision to come back to New Zealand. It is intended as a practical guide to give you general background.

1. *Tax Residency Test*

1.1 Tax residency is different to immigration. You can be tax resident in New Zealand even if you are not a New Zealand citizen or a permanent resident.

1.2 In New Zealand there are two tests for tax residency for individuals.

1.2.1 The first is the physical presence test. This applies where you are in New Zealand for 183 or more days in any 365 day period. The days need not be consecutive. Please note that a part day counts as a full day here (ie if you arrive at 10 minutes to midnight you are deemed to be here the whole day), and that you are deemed to be here and tax resident from the first of the 183 days, ie it is retrospective. By the way, to break your tax residency, you need to be out for 325 days in any 365 day period on the same basis.

1.2.2 The second test is the permanent place of abode test. This is a nebulous test that looks at the strength and duration of your links with New Zealand. Having a permanent home available to you in New Zealand is not in and of itself enough to necessarily make you a tax resident in New Zealand. However, having your family living in New Zealand while you continue to live and work overseas could well see you as having a permanent place of abode and being tax resident.

1.3 Ordinarily a tax resident is subject to income tax in New Zealand on their worldwide earnings and assets, whether or not that income is repatriated to New Zealand. There is an exception to this where you are a transitional tax resident. This applies to either a person who has not been tax resident in New Zealand before, or in your case, a returning Kiwi who has been non-tax resident of New Zealand for at least 10 years.

1.4 A transitional resident is taxed as such for the month in which they return to New Zealand, plus the subsequent 48 months. During this time, they are taxed only on their New Zealand sourced income and their worldwide employment and services income (eg directorships). All other forms of foreign sourced income are not subject to income tax in New Zealand during the transitional residence time even if that income is repatriated to New Zealand. This allows time to tidy up overseas affairs such as rental properties, pension funds and the like.

1.5 It is also possible that an individual can be dual tax resident, ie tax resident in two or more countries. Naturally, you will need to consider the tax residency rules in the country that you have returned from and find out what you need to break those. It may be that you are still tax resident in the foreign jurisdiction after you have arrived in New Zealand, simply because they may tax on a whole of year basis as opposed to on a daily basis as New Zealand does.

1.6 New Zealand has signed a number of double tax agreements with foreign countries which provide some relief from dual tax residency. These typically are based on the OECD model double tax agreement and provide a series of hierarchal tests to determine which country you are deemed to be tax resident of and which country you are treated as non-resident of. Naturally in the foreign jurisdiction, this can also have significance around capital gains tax.

1.7 Typically, these DTA tie breaker tests look firstly at whether you have a permanent home available in New Zealand, the overseas country or both. The home need not be owned and can be either rented or made available by a trust. The country in which you have a permanent home available, if there is only one, wins and treats you as resident and the other treats you as non-resident. If you have a permanent home available in both, then you move on to the second test.

1.8 The second test is typically the country with which you have closer personal and economic relations. This is similar to the permanent place of abode test and tries to work out with which country your links are stronger. In the example above where an individual is overseas, but their family is residing back in New Zealand, it is for this reason that they can again find themselves tax resident in New Zealand.

2 Implications

2.1 Firstly, you need to consider which country you are tax resident in presently and to work out what you need to do to break the tax residency there. You will also need to understand the implications in that country. For example, in Australia and in the UK which have capital gains tax, there is often a deemed disposal of your assets when you cease to be a tax resident in that country, ie you are deemed to have disposed of your worldwide assets at their market value when you cease to be a tax resident in those countries. Similarly, some foreign countries do have death duties such as the UK and USA. Finally, some countries such as the USA also tax on the basis of citizenship so regardless of where you are in the world, if you are a citizen, the USA will expect you to pay taxes in the US every year.

2.2 New Zealand taxes your worldwide earnings if you are an income tax resident. By comparison, a non-resident is subject to income tax only on income sourced in New Zealand.

2.3 Transitional residency does provide significant planning tools for returning expats to New Zealand and new migrants to New Zealand. It allows you time to return to New Zealand, check that you are happy to stay here and put roots down, before deciding to collapse overseas pension funds, investment structures and the like and to look to onshoring these or at least making them tax effective in New Zealand. Similarly, there are often issues with overseas trusts which will need to be addressed during the transitional residency period.

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2.4 If you are not going to be transitional resident, then it is also very important that you seek advice prior to returning to New Zealand.

2.5 Transitional residents and their spouses cannot apply for the Working for Families benefit if they are transitional tax residents.

2.6 While COVID may have had implications on your ability to pop home for a holiday prior to making the final decision to return here permanently, you should also be careful that if you return to New Zealand for a holiday within a 6 month period prior to moving back permanently, because of the way the 183 day test works, you could be deemed tax resident from the start of the holiday period. Clearly this is undesirable.

3 Trusts

3.1 New Zealand has a unique tax law for trusts. Firstly, it taxes trusts based on the tax residency of the settlor irrespective of what country the trust was actually set up in. Your typical New Zealand trust owning New Zealand assets settled by a person tax resident in New Zealand is going to be subject to income tax in New Zealand on its worldwide earnings. We refer to these as complying trust for taxation purposes.

3.2 Where a trust has been set up overseas by either a non-resident New Zealand citizen, or a person who is not tax resident in New Zealand, these trusts are typically going to be what we call foreign trusts. These trusts are subject to tax in New Zealand only on their New Zealand sourced income or distributions to Newtax resident beneficiaries while the settlor remains non-tax resident in New Zealand. However, after the settlor returns to New Zealand, an election needs to be made within the first year of tax residency, or within 12 months of the expiry of transitional tax residency, to bring the trust onshore and make it subject to New Zealand income tax from the end of the transitional residency period (or if not transitional resident the commencement of tax residency in New Zealand). This election maintains the previous foreign trust status up to the point where the person comes to New Zealand, and makes it a complying trust subject to New Zealand tax thereafter.

3.3 The significance of this is firstly that earnings accumulated in the trust prior to returning to New Zealand may be subject to income tax when paid out subsequent to arrival in New Zealand. For this reason, if you do have a trust created outside New Zealand, it is always advisable to obtain advice prior to returning to New Zealand. Often we will see this trust wound up, assets transferred back to the individuals, and then potentially resettled on a new trust in New Zealand which is a complying trust. This saves the past accumulated earnings and capital gains from being subject to income tax.

3.4 If an election is not made to bring the trust back onshore then the trust becomes what is called a 'non-complying' trust. Post return earnings and gains are subject to income tax in New Zealand at a penal rate of 45% income tax. Moreover, for both foreign trusts and non-complying trusts there are what are called ordering rules which creates a deeming regime to classify the amounts paid out by the trust. It ensures that what is paid out first is what is going to be most highly taxed in New Zealand.

3.5 If you do have a trust created while you have been outside New Zealand, the best advice is to obtain New Zealand tax advice before you come back to New Zealand, even if it is likely that you are going to be transitional residents.

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4 Specific Issues

4.1 Wages: New Zealand taxes wages on a cash basis. If you are a transitional resident, New Zealand will tax foreign wages that you are paid subsequent to returning to New Zealand. It is however possible that deferred gains relating to employment pre-return to New Zealand may be non-taxable. Again specific advice should be taken.

4.2 Employee Share Plans etc: These are taxed as employment income in New Zealand and are fully taxed at the time when the employee becomes entitled and economically exposed to the share gains. The rules regarding this in New Zealand have changed in the last few years to ensure that arrangements to protect the downside in value for an employee are no longer effective. Arrangements such as put options, forward sale agreements and the like which were used to ensure that employees could make gains but not losses, are generally not effective anymore.

4.2.1 New Zealand citizens returning to New Zealand with interest in foreign employment share schemes will need to take advice but will need to try to ensure that these gains vest in them from a taxation viewpoint prior to returning to New Zealand so that that income is not taxable here, noting that of course even transitional residents are subject to tax on worldwide employment income in New Zealand.

4.2.2 Often people returning to New Zealand will seek to continue to work for their previous foreign employers, either on wages or as a contractor. Naturally while that income is taxable in New Zealand, there are some nuances that need to be considered. Firstly as an employee, there is no ability to claim costs as a deduction against your earnings. Secondly, as an employee if your non-resident employer does not deduct PAYE from your wages (which they are unlikely to) in New Zealand, then technically you are required to remit the PAYE from your own wage to the IRD each month. There are specific forms to handle this. It is also important to remember that foreign tax should not be deducted even if you are working for your old employer in your old country, where the services are physically provided in New Zealand.

4.2.3 Again, appropriate structuring can see significant benefits for you.

4.3 Pension Funds: There are specific rules around employment related foreign pension funds which defer the taxation on these until when the payout occurs. Typically that means if you are returning to New Zealand with one that qualifies, you won't be paying tax in New Zealand until you start drawing the funds out. There is also a scaled percentage of these that are taxable when they do pay out, depending on how long you have been in New Zealand.

4.3.1 Other forms of pension funds not related to employment, or where you continue to contribute to foreign employment schemes after returning to New Zealand, will see the unrealized gain in value in New Zealand dollars of your foreign pension scheme subject to income tax each year after the expiry of the transitional tax residence period if applicable.

4.3.2 For this reason we recommend that you obtain advice on your foreign employment scheme prior to returning to New Zealand. To the extent it is possible, these can be paid out prior to New Zealand even if you chose to reinvest them in an appropriate structured New Zealand scheme.

4.4 Real Estate: If you continue to own real estate overseas then during the transitional residency period New Zealand will not seek to tax those rents or to require you to

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report any income or gains in New Zealand. At the expiry of the transitional residence period, or if you are not a transitional resident, then any foreign rents will be subject to income tax in New Zealand, even if they are taxable overseas, although a credit is allowed for any foreign taxes paid against the New Zealand tax payable. Care also needs to be taken as to whether sale of residential property which was not a home is subject to tax here under the Brightline rules for residential property.

4.4.1 While the rents may be taxable, a deduction is allowed for costs incurred in producing that income, and certain items for depreciation (although residential dwellings are not subject to depreciation for the building component).

4.4.2 Adverse issues can also arise in relation to foreign loans used to fund the foreign real estate. Unbelievably, the interest paid on these can be subject to withholding tax in New Zealand once you have returned, and the change in value of those loans can be subject to income tax in New Zealand on potentially an unrealised basis depending on the amounts involved.

4.4.3 If you are not transitional resident, then again the best advice is often to sell the real estate prior to returning to New Zealand. Again, advice should be taken.

4.5 Shares/Unit Trusts: New Zealand operates a unique system to tax foreign shares and unit trusts. Instead of taxing the actual dividends or the capital gains, New Zealand has a deemed rate of return method whereby 5% of the market value on the first day of each income tax year in New Zealand is the deemed income that arises from those investments. For a transitional resident, naturally this will commence at the end of the 48 month transitional period, but for people that are not transitional residents, this is something to be cognisant of and again consideration can be given to disposing of foreign shares prior to returning to New Zealand. There are some more tax advantage structures and schemes in New Zealand involving PIE funds and the like which should be considered.

5 Summary

5.1 The key is to obtain advice before you come back to New Zealand, but some knowledge is certainly helpful. The key is to understand firstly whether you will be transitional resident or not and then which aspects of New Zealand tax could adversely affect you. If you are a transitional resident, then timing at least provides a 48 month window for you to get a lot of these issues sorted.

5.2 Trusts in particular are problematic where you have created a trust while you have been non-resident in New Zealand. Specific advice should be taken on trusts.

5.3 Finally, while COVID has impacted on the ability to come to New Zealand because of the quarantine and travel restrictions, be careful that if you do come to New Zealand and then as a pre-cursor to moving back, and then return within 6 months, you may inadvertently become tax resident in New Zealand from that initial visit.

5.4 Also, you will need to obtain specific advice in relation to your existing jurisdiction and breaking the tax residency there, along with the consequences to that.

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6 Why Us

6.1 Covisory are specialists in New Zealand and international tax and trusts. We regularly work on these types of engagements dealing with people like you.

6.2 We can work equally with your existing offshore advisors or we have our own extensive international network to tap into.

6.3 We can also handle your New Zealand accounting and the nuances of it as it applies to both your New Zealand assets and income, and your international tax complications.

6.4 We also have strong onshore links to all services that you will require such as immigration, banking, real estate, insurance, lawyers etc.

6.5 Above all, we offer proactive and practical advice.

About Covisory

The Covisory Group specialise in International and Domestic Tax Services, Trust Management, Succession Planning, Strategic and Business Planning, Accounting Services and Business Valuations.

Established in 2007, The Covisory Group has grown from one business to four with a diversity of clients. Covisory clients are owners of family businesses, operating both in New Zealand and globally. Our team of specialists work either one-on-one or alongside our clients' team of professional advisers to develop appropriate short- and long-term solutions.

We build strong relationships with our clients based around trust, accessibility, and responsiveness. There is no 'one size fits all' about our services. Our solutions are bespoke to each client, drawing on our up-to-date specialist knowledge and our years of experience. providing one-on-one expert advice.

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