

15 August 2002

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Dear Keith

Fund Withdrawal Tax

We are writing on behalf of the Association of Superannuation Funds of New Zealand (“ASFONZ”), to seek clarification and/or legislative amendment with regard to issues arising from application of subpart CL of the Income Tax Act 1994.

1. Member contributions made on behalf of a member who joins a pre-existing scheme after 31 March 2000

1.1 This issue involves an employee who has a pre 1 April 2000 employment agreement that allows for them to join a scheme, but the employee has not previously taken up this option. Paragraph CL 8(4)(c) states that an employer is not treated as making specified superannuation contributions to a superannuation fund that have increased by 150% or more than the previous year if:

“(c) the employer starts making specified superannuation contributions on a member’s behalf in accordance with a contract, or an amendment to a contract, that was signed before 1 April 2000.”

1.2 The paragraph exempts the current situation from the withdrawal tax if the employee later ceases employment¹.

1.3 We seek clarification as to the application of subsection CL 3(4) to this fact situation. Subsection CL 3(4) states:

¹ Refer to paragraphs CL 8(2)(b) and (c).

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“An employer is not treated as increasing the level of specified superannuation contributions to a superannuation fund if –

- (a) the increase is required by a trust deed or a contract, or an amendment to a trust deed or a contract, and the increase is a requirement that existed before 1 April 2000; or*
- (b) the level of specified superannuation contributions since the last pay period ending before 1 April 2000 has not changed as a percentage of salary.”*

1.4 The Commentary to the Bill is unclear on the issue when at page 5 it states:

“Existing contributions and contributions that continue at current levels will not be subject to the withdrawal tax.”²

1.5 That comment suggests that contributions that begin after 1 April 2000, as in our example, will be subject to the withdrawal tax, as they are not “existing” or “continuing” even though provided for in a pre 1 April 2000 contract. However, further on at page 6 of the Commentary is the statement that:

“...already determined levels of future contributions will not be affected by the fund withdrawal tax.”³

1.6 As the levels of future contributions are already determined in the employment contract existing before 1 April 2000, this statement suggests they should not be affected by withdrawal tax. The Tax Information Bulletin that discusses the tax offers no guidance in this area⁴.

1.7 Could you please clarify the Department’s policy surrounding subsection CL 3(4) in the context of the example outlined in paragraph 1.1.

² Hon Dr Michael Cullen, *Taxation (FBT, SSCWT & Remedial Matters) Bill, Commentary on the Bill*, March 2000, p5.

³ *Supra* at p 6.

⁴ Inland Revenue Department TIB, *Vol 12, No 11 (November 2000)*.

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2. What happens to withdrawals made from post 31 March 2000 surplus contributions created before the employee was employed?

- 2.1 Sections CL 8 and CL 10 both contain exceptions to a withdrawal being gross income and subject to fund withdrawal tax as contained in section CL 4. Subsections CL 8(7) and CL 10(2) define “withdrawal” for the purpose of each section. Both provide that “withdrawal” means amounts contributed to a fund whilst the employee is employed. The exceptions contained in sections CL 8 and CL 10 will not apply if the surplus is used to fund post 1 April 2000 employer contributions since the amounts physically contributed to the fund were made prior to the employment of the member.
- 2.2 It appears that the wording of the subsections is too restrictive in terms of the policy behind the exceptions. In the TIB, Inland Revenue comments suggest the rationale behind subsection CL 8(7) is to take into account possible multiple employers, whereas subsection CL 10(2) in respect of defined benefit funds operates such that “...all withdrawals from a defined benefit fund are exempt on cessation of employment”⁵.
- 2.3 We suggest that the current legislation does not meet the policy objectives in this situation. It appears that a legislative amendment is required to correct this wording deficiency. We look forward to your comments.

3. Withdrawals made after a scheme’s surplus expires

- 3.1 Where employer contributions are met by way of transfers from reserves which are then exhausted, and the employer commences making specified superannuation contributions of the same net amounts as the sums previously transferred from reserves, the exemption prescribed in paragraph CL 3(1)(d) will not apply.
- 3.2 We suggest that a legislative amendment is required to correct this anomaly. The exemption should apply whenever the level of specified superannuation contributions made by an employer on a member’s behalf does not exceed the rate at which employer contributions were credited to the member pre – 1 April 2000, by way of transfers from reserves.

⁵ Inland Revenue Department TIB, Vol 12, No 11, p 19.

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4. Acquisitions/Corporate Restructurings

- 4.1 Another area of concern is that if a scheme member transfers his or her employment to a new (unrelated) employer in a takeover situation, it appears he or she will be treated for the purpose of subpart CL as having “ceased employment” on the date of the transfer of employment, despite the member’s employment being, practically speaking, continuous. The two-year period of employment pre-withdrawal for the purposes of the section CL 8 exemption will then be calculable from the date of transfer of employment.
- 4.2 We suggest amending the legislation so as not to defeat the availability of the paragraph CL 8(2)(a) exemption when an employee transferring to a new employer following a takeover then leaves the purchaser’s service within two years post-transfer. One approach would be to add to paragraph CL 8(2)(a) the words “*by an employer or its predecessor in business*”.

5. Defined Benefit Funds that convert to superannuation funds other than defined benefit

- 5.1 Section CL 10 deals with funds that are defined benefit funds for the purpose of subpart CL. It is common for defined benefit funds to convert to defined contribution. Sections CL 17 to CL 19 contain transition rules for superannuation schemes becoming superannuation funds and vice versa as well as superannuation funds becoming foreign superannuation schemes.
- 5.2 However, the current rules in subpart CL do not adequately deal with the “conversion” of a defined benefit fund to a fund that no longer satisfies the definition of “defined benefit fund” in section OB 1.
- 5.3 We suggest that a “grand-fathering” provision such as section CL 19 be inserted to provide that -

“If a defined benefit fund ceases to be a defined benefit fund, all amounts that exist in the defined benefit fund at the time it ceases are treated as being member contributions to the superannuation fund.”

- 5.4 In addition, there should be a transition rule that preserves the level of employer contributions to a defined benefit fund prior to its ceasing to be a defined benefit fund as exceptions within subsection CL 3(1) where those levels remain unaltered

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going forward. It is possible that actuarial determination of contribution levels may be required.

If you have any questions do not hesitate to contact me.

Yours sincerely
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Geoff Blaikie
Director