Taxation of defined benefits funds

Guidance on taxation of defined benefit funds.

QC 105115

Defined benefit funds – notional taxed contributions

Determine the notional taxed contributions for members who have a defined benefit interest with your fund.

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Notional taxed contributions

Contributions made to defined benefit funds are not always linked to individual members. You must work out the notional taxed contributions for all your members who have a defined benefit interest with your fund.

Given the level of detail in the Regulations, this information is intended as general guidance only. It does not apply to a super interest in a constitutionally protected fund.

If your super fund offers a defined benefit interest, you must determine and report each member's notional taxed contributions for each financial year, from the 2012–13 year onwards.

A member holds a defined benefit interest within a super fund if all, or part, of the super benefits payable to them are defined by:

- reference to their salary or another person's salary at a particular date or averaged over a period
- a specified amount or a specified conversion factor.

Notional taxed contributions have the meaning given by Subdivision 291-C of the Income Tax Assessment (1997 Act) Regulations 2021.

As trustee of the fund, you must determine each member's notional taxed contributions as required by the Regulations.

If a member with a defined benefit interest is eligible for 'grandfathering' of their notional taxed contributions amount, special rules apply to how you determine their notional taxed contributions.

When you report member contributions to us for financial years prior to 2017–18, you must include the amount of notional taxed contributions you have determined for the member.

For more information about calculating notional taxed contributions, see Income Tax Assessment (1997 Act) Regulations 2021.

Definition of grandfathering

Grandfathering of notional taxed contributions generally occurs where a defined benefit account was opened prior to 12 May 2009. A member’s super fund will determine which accounts are eligible for grandfathering.

Where an account is eligible, the amount of notional taxed contributions will be capped at the member's concessional contribution cap. Prior to the 2017–18 financial year, funds would report the capped amount to us. From the 2017–18 financial year onwards, funds report the uncapped amount and we calculate the capping that applies to a member's notional taxed contributions.

For example, if the cap was $30,000 and the notional tax contribution (NTC) was $42,000, then in the:

- 2016–17 and prior financial years, funds would report the capped NTC amount of $30,000.
- 2017–18 and later financial years, the fund would report the uncapped NTC amount of $42,000.

Grandfathering of notional taxed contributions

Eligible members

You must determine each year which, if any, of your members are eligible for the grandfathering provisions.

If your members are eligible, there are special rules to determine their notional taxed contributions.

This may mean that members' notional taxed contributions may be taken to be at, but not more than, the maximum level of their concessional contributions cap.

2009–10 and later financial years

For a member to be eligible for grandfathering of their notional taxed contributions for the 2009–10 and later financial years:

- their notional taxed contribution for the year must otherwise exceed their concessional contributions cap
- they must have either held
  - the defined benefit interest on 12 May 2009
  - a defined benefit interest on 12 May 2009 (the original interest), and all requirements for the transfer of the interest to your fund must be met

- any other conditions in the regulations must be satisfied.

Requirements for the transfer of the interest include the:

- entire value of the original interest was transferred directly to the current interest after 12 May 2009, or was transferred to another super interest after 12 May 2009 and later transferred to the current interest (either directly or through a series of transfers between super interests)
- member's rights to accrue future benefits under the original and current interests must be equivalent
- member's notional taxed contributions before applying the grandfathering rules either
  - don't exceed what they would have been if the transfer had not taken place
  - satisfy any conditions specified in the regulations.

2007–08 and 2008–09 financial years

For a member to be eligible for grandfathering of their notional taxed contributions for the 2007–08 and 2008–09 financial years:

- their notional taxed contributions for the year must otherwise exceed their concessional contributions cap
- they must have either held
  - the defined benefit interest on 5 September 2006
  - a defined benefit interest on 5 September 2006 (the original interest), and all requirements for the transfer of the interest to your fund must be met
- any other conditions in the regulations must be satisfied.

Requirements for the transfer of the interest include the:

- entire value of the original interest was transferred directly to the current interest after 5 September 2006, or was transferred to another super interest after 5 September 2006 and later transferred to the current interest (either directly or through a series of transfers between super interests)

- member's rights to accrue future benefits under the original and current interests must be equivalent
- member's notional taxed contributions before applying the grandfathering rules either
  - don't exceed what they would have been if the transfer hadn't taken place
  - satisfy any conditions specified in the regulations.

Where to report notional taxed contributions

Include the amount of notional taxed contributions in the Member Account Transaction Service (MATS).

Grandfathering examples

Example 1: grandfathering of notional taxed contributions

Peter has a defined benefit interest on 5 April 2009. He also holds an accumulation interest with the same fund and several other funds.

He becomes eligible for grandfathering of his notional taxed contributions in the 2009–10 financial year.

He also salary sacrifices $100 per fortnight into the accumulation interest.

Peter's concessional contributions cap is $25,000 for the 2017–18 financial year.

Although he receives a pay increase during the year, Peter's fund determines he is still eligible for grandfathering of his notional taxed contributions. He also continues to salary sacrifice $100 per fortnight into the accumulation interest.

Peter's defined benefit fund reports $27,000 notional taxed contributions and indicates Peter is eligible for grandfathering.

Peter's other funds report $15,000 of concessional contributions.

We determine if Peter's notional taxed contributions amount needs to be capped.

As his notional taxed contributions are greater than the general concessional contributions cap for the year, and he is eligible for grandfathering, we determine his concessional contributions amount to be $40,000 (capped notional taxed contributions of $25,000 + $15,000).

Example 2: grandfathering eligibility

Susan has held a defined benefit interest since 5 April 2009. As she meets all the conditions, she is eligible for grandfathering of her notional taxed contributions from the 2009–10 financial year onwards.

Susan changes jobs on 1 April 2018 when she obtains a more senior position with another company which also offers a defined benefit plan. Susan isn't eligible for grandfathering in her new fund, as she didn't hold this defined benefit interest on 12 May 2009.

Each of Susan's funds will determine if she is eligible for grandfathering based upon the time the defined benefit interest is opened.

When Susan's old fund reports contributions for the 2017–18 financial year, they will report the uncapped amount of NTCs and indicate whether she's eligible for grandfathering.

When Susan's new fund reports contributions for the 2017–18 financial year, they will also report the uncapped amount of NTCs and advise that she isn't eligible for grandfathering.

We will use Susan’s grandfathering eligibility as reported by her funds to determine the capping of her NTCs.

Reporting disclaimer

The notional tax contributions (NTC) reporting obligation via the *Transfer balance account report* (TBAR) has now been removed.

Funds were previously advised that for the 2017–18 financial year, reporting obligations required defined benefit funds to provide the uncapped NTC amount for grandfathered members.

This was required if the NTC amount exceeded the cap and was capped on the member contribution statement at $25,000. While the NTC reporting obligation via the TBAR has now been removed, if still reported to us it won't have adverse impact on members.

From 2017–18 year onwards, funds are required to report the full notional taxed contributions amount. If a member is eligible for grandfathering, funds are required to indicate this via a new reporting label. We will determine the individual's notional taxed contributions and concessional contributions.

For more information, see Caps, limits and tax on super contributions.

QC 19379

Calculating defined benefit super interest value

Determine the defined benefit super interest value for calculating the pre-July 1983 amount at 30 June 2007.

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When defined benefit super interest applies

This information applies only to superannuation interests that are:

- defined benefit interests in taxed funds
- in the accumulation phase.

What is a defined benefit interest?

A defined benefit interest is generally an interest for which the benefits payable from the interest are defined by reference to a specified amount or matter, commonly the member's salary at a particular time or an average salary for a particular period.

What is the pre-July 1983 amount?

The pre-July 1983 component relates to superannuation entitlements accrued before 1 July 1983. The pre-July 1983 amount forms part of the tax-free component of the interest.

When is the pre-July 1983 amount calculated?

Taxed super funds calculate the pre-July 1983 component of the crystallised segment for all interests that include a taxable component and are in the accumulation phase as at 30 June 2007.

Taxed super funds had until 30 June 2008 to calculate the pre-July 1983 components.

Determining defined benefit super interest

The pre-July 1983 amount for a defined benefit interest is calculated using the following 3 steps:

Step 1

1. Calculate the value of the retirement benefit that would have been payable at 30 June 2007 if the member had been eligible to retire on that date and had elected to do so.
2. If the retirement benefit depends on the member's age, service or salary, or on the employer's consent, assume that the:
   - member's service was their actual service to 30 June 2007
   - member's age was the greater of the minimum age at which a retirement benefit could be taken without the employer's consent and the member's actual age at 30 June 2007
   - member's salary was their salary for superannuation purposes as at 30 June 2007

- employer has consented to the retirement.

3. If part or all of the retirement benefit can be paid as a superannuation income stream, it's necessary to work out 2 amounts:
   - first, the value of the income stream is calculated as
     - the annual rate of the income stream that would have been paid had the maximum proportion of the benefit possible been taken as an income stream
   - multiplied by
     - the applicable factor (for applicable factors see Clause 1, Schedule 1B of the Income Tax Assessment (1997 Act) Regulations 2021
   - then, the total value of the retirement benefit is calculated as
     - the value of any income stream as calculated above, plus
     - the amount of any lump sum payable under the above assumptions had the member taken the maximum possible proportion of their benefits as an income stream.
4. If the superannuation benefit can only be paid as a lump sum, then the value of the retirement benefit is the amount of that lump sum.

Step 2

If a superannuation lump sum benefit, including a rollover superannuation benefit, would have been payable had the member resigned, or withdrawn their benefit on 30 June 2007, calculate the amount of that benefit.

Step 3

The value of the defined benefit superannuation interest for the purpose of calculating the pre-July 1983 amount is either:

- the greater of the values worked out using Steps 1 and 2
- if no value can be determined under Step 2, the value of the defined benefit superannuation interest is the value worked out in Step 1.

Calculating crystallised segment example

Example: calculating crystallised segment

Sebastian is 54 years old and has a defined benefit interest in a taxed super fund. Sebastian's interest is in the accumulation phase. Both Sebastian and his employer contribute to the super fund. Sebastian will be able to take his retirement benefit upon reaching 60 years old.

On retirement, Sebastian will be entitled to be paid up to 50% of his benefits held in the fund as an indexed lifetime income stream and the remainder of the benefits as a lump sum.

If Sebastian had been eligible to retire and had elected to do so at 30 June 2007, the annual rate of the maximum income stream payable would be $10,000 and his lump sum payable would be $100,000.

Sebastian would have been entitled to be paid a lump sum benefit of $200,000 had he actually resigned on 30 June 2007.

Determining the value of interest

Sebastian's fund would determine the value of his interest for the purpose of calculating the pre-July 1983 amount of the crystallised segment of the tax-free component of his interest as follows:

Step 1

Calculate the value of the retirement benefit that would have been payable at 30 June 2007.

As Sebastian would be entitled to take up to 50% of his retirement benefit as an income stream, multiply the annual rate of the maximum income stream by the applicable factor to determine the value of the income stream.

The applicable factor for an indexed lifetime income stream payable to a person 60 years old is 16.513. (See Table 1 of Schedule 1B of the Income Tax Assessment (1997 Act) Regulations 2021.)

> *$10,000 × 16.513 = $165,130*

The total value of the retirement benefit is the sum of the value of the income stream (worked out above) and the amount of the lump sum payable on retirement.

$165,130 + $100,000 = $265,130

Step 2

Sebastian would have been entitled to a lump sum of $200,000 if he had actually resigned on 30 June 2007.

Step 3

The value of Sebastian's defined benefit superannuation interest for the purpose of calculating the pre-July 1983 amount at 30 June 2007 is the greater of the values worked out using Steps 1 and 2.

The value of Sebastian's defined benefit superannuation interest for the purpose of calculating the pre-July 1983 amount of the crystallised segment at 30 June 2007 is **$265,130**.

QC 19618

Our commitment to you

We are committed to providing you with accurate, consistent and clear information to help you understand your rights and entitlements and meet your obligations.

If you follow our information and it turns out to be incorrect, or it is misleading and you make a mistake as a result, we will take that into account when determining what action, if any, we should take.

Some of the information on this website applies to a specific financial year. This is clearly marked. Make sure you have the information for the right year before making decisions based on that information.

If you feel that our information does not fully cover your circumstances, or you are unsure how it applies to you, contact us or seek professional advice.