CR 2006/35 - Income tax: determination of funded portion of a defined benefit pension

Class Ruling

Income tax: determination of funded portion of a defined benefit pension

Contents Para

This Ruling provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (or in a way that is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant taxation provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant taxation provision(s)

2. The taxation provision(s) dealt with in this Ruling are:

- section 159SJ of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 159SM of the ITAA 1936;
- section 159ST of the ITAA 1936; and
- Part IX of the ITAA 1936.

All legislative references in this Ruling are to the ITAA 1936 unless otherwise indicated.

Class of entities

3. The class of entities to which this Ruling applies is:

- 164 current contributors to the scheme, all of whom may potentially receive a pension;

- two deferred beneficiaries, who have left contributory service but not yet commenced a pension; and
- 96 existing and former pensioners of the fund who have already received advice about the extent to which the pension is rebatable plus nine current reversionary pensioners. These pensions commenced between 1 August 1984 and 16 January 2005.

4. This Ruling does not cover commuted pensioners and recipients of refund benefits.

Qualifications

5. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.

6. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 13 to 27.

7. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

Date of effect

9. This Ruling applies from 1 January 2005 until it is withdrawn. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

10. If this Class Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

11. If this Class Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Class Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

12. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Scheme

13. The arrangement that is the subject of this Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, as the case may be form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- Correspondence from the applicant in respect of the Ruling to the Australian Taxation Office;
- Northern Territory Police Supplementary Benefit Scheme Trust Deed and Rules as in force at 20 December 2002; and
- Northern Territory Police Supplementary Benefit Scheme Annual Report 2003-04.

14. The Northern Territory Police Supplementary Benefit Scheme (NTPSBS) is a superannuation fund established under a trust deed dated 15 June 1984. The NTPSBS supplements the pension payable from the Commonwealth Superannuation Scheme (CSS) for members of the Northern Territory Police Force.

15. The NTPSBS is an exempt public sector superannuation scheme under the *Superannuation Industry (Supervision) Act 1993*. As such the NTPSBS is a complying superannuation fund for the purposes of Part IX of the ITAA 1936.

16. The Northern Territory Government and Public Authorities Superannuation Scheme (NTGPASS) replaced the CSS and the NTPSBS for Police recruited after 1 January 1988. The NTPSBS is therefore closed to new members.

17. The NTPSBS trust deed establishes a superannuation fund to accept the contributions of members and income derived from the investment of those contributions.

18. Members finance a share of the NTPSBS benefits by contributing one per cent of their salary to the superannuation fund, which is managed by the Trustees. Each member has an accumulation account in the NTPSBS representing the member's contributions and interest.

19. Member accumulations are invested within the scheme during the period of contributory service, and during the period of deferral. If a member leaves without being entitled to a pension benefit, the accumulated member contributions are paid by the scheme directly to the member, and no other benefit is payable.

20. To qualify for a supplementary benefit a member:

- must be at least 50 years of age or have at least 25 years CSS contributory service when ceasing to be a member of the NTPSBS;
- cease to be a member, otherwise than by reason of death or, where an invalidity benefit has been granted, otherwise than because of invalidity; and
- become entitled to a CSS age retirement pension, early retirement pension, deferred pension or postponed pension on or after ceasing to be a member of the NTPSBS.

21. If a member leaves with a pension benefit, the member's accumulated contributions are paid to the Northern Territory (NT) Government at the point of pension commencement. The NT Government is responsible for the payment of the supplementary benefit. The supplementary benefit consists of a return of the member's accumulated contributions and interest, and unfunded employer-financed benefits. No employer-financed benefits are payable from the scheme.

22. The supplementary benefit is paid as a lifetime indexed pension, which commences when the CSS employer-financed pension begins to be paid. The supplementary pension is calculated as a percentage of the member's CSS employer-financed pension determined by the member's age when ceasing to be a member of the Northern Territory Police Force or a CSS contributor, whichever occurs later, as follows:

Age, in completed years, at the relevant date	**Percentage**
55 or less	25.00
56	21.69
57	18.69
58	15.94
59	13.43
60 or more	11.11

23. A supplementary pension may be commuted to a lump sum equal to ten times the annual amount of the supplementary pension.

24. Pension benefits are increased on 1 January and 1 July in line with increases in the Consumer Price Index (CPI).

25. The particular circumstances of the NTPSBS are that the employer component is paid from an untaxed source, but the member component (contributions and earnings) is accumulated in a taxed environment.

26. The portion of the pension purchased with member contributions is not defined under the rules of the scheme. That is, there is no clear delineation between funded and unfunded parts of the annual pension.

27. Therefore, it is difficult to determine the extent to which the pension is rebatable. The current scheme actuary has suggested that the Trustees should calculate the present value of the pension and determine what fraction of the total present value the accumulated contributions represent. The actuary has also suggested that an appropriate basis for this calculation would be to use the mortality rates given in the relevant Australian Life Tables and an interest rate of 4%. The relevant Australian Life Table for pensions commenced on or after 1 January 2005 is the 2000-02 Australian Life Tables.

Ruling

28. The Commissioner is of the opinion that the methodology proposed by the actuary, who is a Fellow or is an Accredited Member of the Institute of Actuaries of Australia, to determine the portion of the pension to be treated as payable from a superannuation fund is acceptable for purposes of section 159ST. It has been confirmed that the methodology is reasonably justifiable and would be professionally accepted by other actuaries.

29. The Tax Office confirms that the methodology to determine the extent to which the pension is rebatable for purposes of section 159SM proposed by the actuary who is a Fellow or is an Accredited Member of the Institute of Actuaries of Australia in respect of the NTPSBS is reasonable.

Commissioner of Taxation
26 April 2006

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.

30. Subsection 159SM(1) allows a tax offset of 15% in respect of the rebatable proportion of a rebatable superannuation pension. A 'rebatable superannuation pension' is defined in subsection 159SJ(1) as meaning:

> a superannuation pension paid from an RSA or paid from a fund where:
>
> (a) the applicable fund is or has been:
>
> (i) a complying superannuation fund; or
>
> (ii) a fund to which paragraph 23(jaa) or section 23FC, as in force at any time before 30 June 1989, has applied; or
>
> (iii) a fund to which paragraph 23(ja) or section 23F or 23FB, as in force at any time before 18 December 1987, has applied; or
>
> (iv) a fund to which section 79, as in force at any time before 25 June 1984, has applied;
>
> in relation to the year of income in which the first payment date occurs or any earlier year of income; and
>
> (b) the person to whom the pension first became payable is not the trustee of the applicable fund;

31. Therefore, a rebatable superannuation pension means in respect of this situation, a superannuation pension paid from a superannuation fund that is a complying superannuation fund. In the case of NTPSBS, as the benefits are actually paid by the NT Government, the pension is not paid from a complying superannuation fund.

32. However, section 159ST provides that where a superannuation pension is not payable from a superannuation fund, but is effectively funded from a fund, it will be treated as if it were paid from that fund. The purpose of section 159ST is to ensure that where a benefit payable under a pension scheme accrues in a taxable superannuation fund but the pension benefit, once it becomes payable, is paid from another entity, the pension is able to be treated as a rebatable pension as long as any other requirements of section 159SM are met.

33. Section 159ST was designed specifically for certain statutory schemes where part of the benefits payable under the scheme may be funded through a superannuation fund while another part of the benefits might be paid directly out of Consolidated Revenue (for example, the CSS).

34. In the case of the NTPSBS, the operation of section 159ST means that the part of the pension that is referrable to the member accumulated contributions (which accumulated in a taxed superannuation fund) would be entitled to the 15% tax offset under subsection 159SM(1). The balance of the pension, consisting of the unfunded employer-financed component has not been subject to tax within the superannuation fund and therefore, would have no such entitlement.

35. Thus it is necessary to determine the extent (if any) to which the pension payments represent the member's accumulated contributions.

36. In the case of the NTPSBS, the trust deed of the Scheme does not provide such a basis. The level of the member accumulated contributions has no bearing on the actual amount of the supplementary pension to be received by the relevant member. The amount of the supplementary pension is determined as a percentage of the employer-financed CSS pension. The percentage itself being determined by reference to the member's age, in complete years, of the pensioner at the commencement of the pension.

37. The Trustees of NTPSBS obtained actuarial advice concerning a methodology to determine the extent to which the pension is rebatable.

38. The actuary suggested that to determine the extent (if any) to which the pension payments represent the member's accumulated contributions is to:

(a) firstly, calculate the present value of the pension; and

(b) determine what fraction of the present value of the pension represents the member's accumulated contributions.

39. To determine what fraction should be used, the actuary has suggested that the member's accumulated contributions be divided by a conversion factor. The conversion factor is calculated based on the relevant Australian Life Tables and an interest rate of 4%. The relevant Australian Life Tables for pensions that commenced on or after 1 January 2005 is the 2000-02 Australian Life Tables.

Appendix 2 – Detailed contents list

40. The following is a detailed contents list for this Ruling:

References

Previous draft:

Not previously issued as a draft

Subject references:

- annuities & superannuation pensions
- annuity & superannuation pension rebate
- rebatable superannuation pensions
- rebates and offsets
- superannuation
- superannuation pension rebates
- superannuation, retirement & employment termination

Legislative references:

- TAA 1953
- TAA 1953 Sch 1 357-75(1)
- ITAA 1936 23(jaa)
- ITAA 1936 23(ja)
- ITAA 1936 23F
- ITAA 1936 23FB
- ITAA 1936 23FC
- ITAA 1936 79
- ITAA 1936 159SJ
- ITAA 1936 159SJ(1)
- ITAA 1936 159SM
- ITAA 1936 159SM(1)
- ITAA 1936 159ST
- ITAA 1936 Pt IX
- Copyright Act 1968
- SIS Act 1993

ATO references

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