IT 2275 - Income tax : abolition of 30/20 rule

TAXATION RULING NO. IT 2275

INCOME TAX : ABOLITION OF 30/20 RULE

F.O.I. EMBARGO: May be released

REF H.O. REF: L81/75/15 DATE OF EFFECT: Immediate

B.O. REF: DATE ORIG. MEMO ISSUED:

F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1077783	SUPERANNUATION FUNDS	23(ja)
	LIFE ASSURANCE COMPANIES	23F
		Div. 8
		Div. 9B

PREAMBLE

The purpose of this ruling is to explain the practical effect of the abolition of the rule known as the 30/20 rule. That rule required life assurance companies and two categories of superannuation funds to hold at least 30% of their assets in public securities, including at least 20% in Commonwealth securities, to enable them to qualify for special income tax concessions.

2. The Taxation Laws Amendment Act 1985 ("the amending Act") amended the Income Tax Assessment Act 1936 ("the Act") to abolish the 30/20 rule, with effect from the year of income in which 11 September 1984 occurred. The amending Act came into operation on 30 May 1985.

RULING

Superannuation Funds

3. The 30/20 rule, as it applied to superannuation funds, was contained in section 121C of the Act, which provided that the investment income of a superannuation fund to which paragraph 23(ja) (non-employee funds) or section 23F (employee funds) applied was not exempt from tax unless, at all times during the year of income, the fund satisfied the rule. The amending Act removed this condition with effect from the year of income of the superannuation fund in which 11 September 1984 occurred, so that compliance with the 30/20 rule was not required during any part of the year of income in which 11 September 1984 occurred - including any period prior to that date - or in any subsequent income year. For most relevant superannuation funds, the 30/20 rule ceased to apply from (and including) the 1984-85 income year but for some funds with substituted accounting periods it would have ceased to apply from (and including) the 1983-84 income year.

4. The Taxation Laws Amendment Act (No. 2) 1985 introduced statutory loan back rules for employer-sponsored superannuation funds with effect from the 1985-86 income year but abolition of the 30/20 rule meant that there were no specific statutory rules governing the investment of superannuation fund assets for the

1984-85 income year and, in the case of some funds with substituted accounting periods, for the 1983-84 income year. However, existing administrative rules which effectively restricted the amount a fund could lend back to a sponsoring employer or associated entity without endangering the taxation concessions available in respect of contributions made to the fund were revised for application in the interim. The revised administrative rules require that superannuation funds conducted in accordance with the provisions of section 23F of the Act must not lend back to the employer sponsor of the fund (either directly or by the use of some device) a larger amount than would have been permitted had the 30/20 rule continued to apply. In deciding whether a particular arrangement represented a loan back prior to the 1985-86 income year, the basis set out in Taxation Rulings No IT294, IT2067 and IT2252 is to be followed.

5. Accordingly, where the trustees of a section 23F fund have, at all times during the 1984-85 income year, maintained not less than 30% of the gross cost of the fund's assets in arm's length investments and the fund satisfies the requirements of section 23F, the income of the fund would be exempt from tax. However, where the trustees of a section 23F superannuation fund have lent greater than 70% of the gross cost of the fund's assets to the employer sponsor, the income of the fund for that year of income would generally fall for assessment in terms of section 121DAB of the Act. Provisional tax is not to be levied.

6. There may be particular cases where the proper conclusion is that the fund has been conducted in a manner which does not satisfy the requirements of paragraphs 121DAB(a) and (b). In this event, the income of the fund should be assessed under section 121DA, with sub-section 82AAC(2) applying to deny deductions for contributions by the employer(s).

Life Assurance Companies

7. A life assurance company which satisfied the 30/20 rule qualified for the following concessions available under Division 8 of the Act -

- exemption from tax of investment income attributable to superannuation and other eligible policies (section 112A);

- a special deduction calculated by reference to a certain proportion of the company's calculated liabilities (section 115); and

- exclusion from the restriction on the section 46 rebate allowable in respect of assessable inter-corporate dividends received by a life assurance company (section 116A).

8. Abolition of the 30/20 rule has had the result that, for the whole of the year of income in which 11 September 1984

occurred (including any period prior to that date), and all subsequent years of income, exemption under section 112A is not dependent on compliance with the rule. Similarly, for those years, the section 116A restriction on the section 46 rebate has no relevance. The amending Act therefore repealed section 116A with effect from the year of income in which 11 September 1984 occurred.

9. The deduction in relation to calculated liabilities available to a life assurance company under section 115 is of a different nature to the fixed concessions available under section 112A and 116A. Prior to the abolition of the 30/20 rule, the basic deduction of 1% of a proportion of a life assurance company's calculated liabilities was increased on a sliding scale for over-compliance with the 30/20 rule and reduced on a sliding scale (to no less than 0.75%) for under-compliance. Consequent upon the abolition of the 30/20 rule, the deduction in relation to calculated liabilities is a flat 1%, available for the years of income subsequent to the year (called the transitional year) in which 11 September 1984 occurred. The deduction available in the transitional year is determined under a specific provision (sub-section 18(2)) of the amending Act. Broadly, the calculated liabilities deduction for the transitional year is the appropriate proportion of the sliding scale deduction from the start of the company's year of income to 10 September 1984 plus the appropriate proportion of the flat 1% deduction for the rest of the year.

10. Specifically, the deduction in the transitional year of income is calculated in accordance with the formula

$$\frac{AB + CD}{E}$$, where -

A (the "former section 115 amount") is the amount that would have been allowed as a deduction under old section 115 if the year of income had ended on 10 September 1984;

B is the number of days in the transitional year before 11 September 1984 during which the company was a life assurance company;

C (the "new section 115 amount") is the amount, calculated at the flat rate of 1%, that would be allowable as a deduction under new section 115 if the company were a life assurance company during the whole of the year of income;

D is the number of days in the transitional year of income after 10 September 1984 during which the company was a life assurance company; and

E is the number of days in the transitional year of income.

11. For the purpose of calculating components B and E of the formula in relation to a life assurance company with a

substituted accounting period and a transitional year of income that commenced before 1 March 1984, account should be taken of the fact that 1984 was a leap year.

12. The calculation of component A requires that the value, as at 10 September 1984, of the following items be determined -

- the company's liabilities;
- those assets included in the insurance funds of the company from which the company derives assessable income; and
- all assets included in the insurance funds of the company.

13. It is expected that life assurance companies will not have had an actuarial valuation of liabilities made as at 10 September 1984 and that their value as at that date will need to be determined in accordance with sub-section 114(2). Unless an actuarial valuation of liabilities was made as at 10 September 1984, it will therefore be necessary to determine the proportion which the last preceding valuation of liabilities bears to the value of all assets of the company as at the date of that valuation and apply that proportion to the value of all assets of the company as at 10 September 1984 (see the following paragraph) to determine the deemed actuarial valuation of liabilities as at that date. The amount of calculated liabilities is then ascertained in accordance with sub-section 114(1) treating, for the purposes of that sub-section, the deemed valuation as having been made on the same basis as the last preceding valuation.

14. Where the actual value of relevant assets as at 10 September 1984 is known, these are, of course, to be used in the calculation of component A of the formula. However, where their value is not known, sound estimates based on monthly or quarterly balance sheet figures or other relevant information are to be accepted. For example, in the absence of factors which may indicate otherwise, pro-rating an increase in assets between monthly or quarterly balance dates should be regarded as a reasonable basis on which to estimate the value of assets as at 10 September 1984.

15. Component C of the formula is to be determined by notionally applying new section 115 in the transitional year of income as if the company was a life assurance company during the whole of that year and on the basis of calculated liabilities and asset values ascertained at the end of that year.

16. Another provision (sub-section 18(3)) of the amending Act that applies for the transitional year of income relates to the operation in that year of section 116AA of the Act, which reduces the amount of the dividends to be taken into account in calculating the rebate allowable to a life assurance company under section 46 of the Act. The provision is relevant to the application of sub-paragraph 116AA(1)(a)(ii) (including its

application for the purposes of sub-paragraph 116AA(1)(a)(iii)) - that is, where a deduction is allowable under section 115 - and recognises that a section 115 deduction in the transitional year of income may have two components - the "former section 115 amount" and the "new section 115 amount" (see paragraphs 9 and 10 above).

17. Sub-section 18(3) of the amending Act ensures that, in applying section 116AA where there is a composite section 115 deduction in the transitional year, account is taken of the value of relevant shares and assets not only as at the end of the year of income, in relation to the "new section 115 amount", but also as at 10 September 1984, in relation to the "former section 115 amount". The value of relevant shares as at 10 September 1984 should be able to be readily determined, while the value at that date of relevant assets from which the company derives assessable income and of all relevant assets of the company should be the same value as determined for the purposes of section 115.

Amendment of Assessments

18. Section 39 of the amending Act provides authority of the amendment of assessments made prior to 30 May 1985 should that be necessary to give effect to the provisions of that Act.

COMMISSIONER OF TAXATION

10 April 1986

<