SCR 97/1 - Superannuation contributions: actuarial method for the calculation of the notional surchargeable contributions factor

Superannuation Contributions Ruling
Superannuation contributions: actuarial method for the calculation of the notional surchargeable contributions factor

Superannuation Contributions Rulings do not have the force of law. Each decision made by the Australian Taxation Office is made on the merits of each individual case having regard to any relevant Rulings and Determinations.

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What this Ruling is about

1. This Ruling provides guidance to actuaries in relation to the preparation of actuarial certificates which deal with the notional surchargeable contributions factor required under the *Superannuation Contributions Tax (Assessment and Collection) Act 1997* (the Act).

Class of person/arrangement

2. This Ruling is relevant to actuaries who have been asked to prepare an actuarial certificate which advises a defined benefits superannuation provider of the notional surchargeable contributions factor(s) for a defined benefits superannuation scheme. Such advice is required for the purposes of the Act.

Background

3. Subsection 8(3) of the Act provides that the surchargeable contributions for a member of a defined benefits superannuation scheme are worked out using the formula:

annual salary x notional surchargeable contributions factor.

4. Section 43 of the Act defines the notional surchargeable contributions factor as the factor applying to a member of a superannuation (defined benefits) provider for that year as certified by an eligible actuary according to Australian actuarial practice.

5. The Australian Government Actuary has prepared a method to assist actuaries who have been asked to prepare an actuarial certificate

which advises a defined benefits superannuation provider of the notional surchargeable contributions factor(s) for a scheme.

Ruling

6. The approach contained in the Australian Government Actuary's method (in the Attachment) is an acceptable approach for an actuary to adopt in the preparation of an actuarial certificate dealing with the notional surchargeable contributions factor.

Date of effect

7. This Ruling has effect from today.

Explanations

8. The method in the Attachment has been prepared by the Australian Government Actuary and the Australian Taxation Office.

9. The method is issued to provide actuaries with a standard to follow when providing certificates which advise on the notional surchargeable contributions factor for the purposes of the Act.

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Attachment

Method for the calculation of notional surchargeable contribution factors for the purposes of subsection 8(3) of the *Superannuation Contributions Tax (Assessment and Collection) Act 1997*

This Attachment is intended specifically for an actuarial audience. Other readers dealing with a specific problem or matter should not rely solely on this Attachment but should get appropriate professional advice.

C Thorburn
Australian Government Actuary
August 1997

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1. Introduction

1.1 The *Superannuation Contributions Tax (Assessment and Collection) Act 1997* (the Act) requires trustees of defined benefits superannuation schemes to provide advice to the Australian Taxation Office on scheme members' surchargeable contributions for a financial year.

1.2 Subsection 8(3) of the Act defines "the surchargeable contributions for a financial year of a member of a defined benefits superannuation scheme" as "the amount worked out using the formula:

annual salary x notional surchargeable contributions factor"

where the notional surchargeable contributions factor is defined in section 43 of the Act as "the factor applying to the member for that year as certified by an eligible actuary according to Australian actuarial practice".

1.3 This Attachment is provided as a standard for actuaries to follow in providing advice of the notional surchargeable contribution factor (NSCF).

1.4 The method in this Attachment is intended only for the purpose of calculating the NSCF and should not be assumed to be relevant for any other purpose.

2. Definitions

Accruing members	An accruing member is a member who is not a non-accruing member.
Accumulation schemes	A superannuation scheme which is not a defined benefits superannuation scheme.
Act (the Act)	*Superannuation Contributions Tax (Assessment and Collection) Act 1997*.
Actuary	A Fellow of the Institute of Actuaries of Australia or an Accredited Member of the Institute of Actuaries of Australia (defined as 'eligible actuary' in section 43 of the Act).
Annual salary	Annual salary is defined in subsection 8(3) of the Act. See also section 5.1of this Attachment.
ATO	Australian Taxation Office.
AWE, AWOTE	Average Weekly Earnings, and Average Weekly Ordinary Time Earnings - salary and wage indices published by the Australian Statistician.
Certificate	The certificate defined in Part 7 of this Attachment.
CPI	Consumer Price Index - price index published by the Australian Statistician.
Defined benefits superannuation scheme	See section 43 of the Act.
Non-accruing members	Non-accruing members are members of the scheme who, for the purposes of the NSCF, have a nil contribution reported, because their benefit is of such a form that it complies with the conditions as set out in section 3.3of this Attachment.
NSCF	Notional surchargeable contributions factor - see section 43 of the Act.
Reporting period	A financial year or part thereof for which contributions are to be reported. The first reporting period is the financial year 1996-97.

SIS	*Superannuation Industry (Supervision) Act 1993*.
Trustee	See section 43 of the Act.

3. Calculation methodology

3.1 General approach

3.1.1 The intention is for NSCF to be calculated in a manner consistent with Professional Standard 402 issued by the Institute of Actuaries of Australia (IAA).

3.1.2 It is intended that the NSCF be calculated as the present value of *employer provided benefits accruing in the year* using the actuarial assumptions determined in accordance with Parts 4 and 5 of this Attachment. The NSCF is to be expressed as a percentage of salary as defined in section 5.1 of this Attachment.

3.1.3 The Projected Unit Credit (PUC) method is to be applied.

3.1.4 *Employer provided benefits accruing in the year* are to be determined as the difference between *the normal cost of total benefits accruing in the year* and the value of anticipated member contributions in the year.

3.1.5 *The normal cost of benefits accruing in the year* is defined as the difference between the *actuarial value of accrued benefits* at <u>the end of the year</u> and at <u>the beginning of the year</u>, both valued at the same point in time.

3.1.6 The *actuarial value of accrued benefits* at both <u>the beginning of the year</u> and <u>the end of the year</u> is to be calculated assuming experience in the year is exactly in line with that assumed.

3.1.7 The *actuarial value of accrued benefits* has the meaning as set out in Paragraphs 5 and 19 of the IAA Professional Standard 402.

3.2 Valuation of benefits

Retirement benefits

3.2.1 Accrued retirement benefits are to be determined using the Actual Accrual Approach, as set out in Paragraph 9(a) of the IAA Professional Standard 402.

3.2.2 Where there is no stated accrual rate, for example, if a benefit is subject to a minimum not related to periods of service or membership, the Proportionate Approach, as set out in

Paragraph 9(b) of the IAA Professional Standard 402, may be used.

Death and disablement benefits

3.2.3 Accrued death and disablement benefits are to be determined using the Accrued Retirement Benefit Approach, as set out in Paragraph 12(a) of the IAA Professional Standard 402.

3.2.4 Where there is no stated accrual rate, for example if a benefit is subject to a minimum not related to periods of service or membership, the Proportionate Approach, as set out in Paragraph 12(b) of the IAA Professional Standard 402, may be used.

Resignation benefits

3.2.5 Accrued resignation benefits are to be determined using the approach set out in Paragraph 14 of the IAA Professional Standard 402.

3.2.6 Where a vesting scale applies and resignation benefits are being projected into the future, the Vesting Factor at Projected Resignation Date is to be used, as set out in Paragraph 15(a) of the IAA Professional Standard 402.

3.3 Application

3.3.1 The NSCF should be applied to accruing members. These are members who are not non-accruing members as defined in Part 2 above. A nil NSCF applies to non-accruing members.

3.3.2 Non-accruing members are members:

- who remain members of the superannuation scheme as pension beneficiaries in payment and whose pension payments:
  - ◊ are either fixed in dollar terms; or
  - ◊ increase at rates which are consistent with the conditions assumed in the NSCF certificates produced while they were accruing members; or
  - ◊ commenced prior to the first NSCF certificate for the superannuation scheme, and increase at rates consistent with the current certificate; or

- who maintain a preserved benefit in the superannuation scheme or, while continuing to be members of the superannuation scheme, have accrued their benefits in full before the commencement of the period, as long as the rules of the superannuation scheme provide that the benefit is:

  ◊ not increased in nominal terms; or

  ◊ increased at a rate reflecting general price increases (for example, adjusted in line with the CPI); or

  ◊ increased at a rate reflecting the general level of salary growth or salary growth for relevant scheme membership (for example, adjusted in line with AWE or AWOTE); or

  ◊ increased as a result of an increase in the individual member's salary; or

  ◊ increased at a rate reflecting the earning rate of the assets of the scheme or part of the scheme to which the member belongs; or

  ◊ increased at a regular rate (or rate based on a formula) which the actuary expects will be not more than the greatest of those listed above;

and is considered by the actuary not to represent a subsidy to those members in the long term.

3.4 'Negative' contributions in any one year

3.4.1 Where the application of the calculation methodology results in a negative NSCF, the NSCF is zero.

3.5 Pro-rating of the NSCF

3.5.1 Where a member is not liable for the surcharge for the full year, the NSCF should be pro-rated to reflect the period for which the member is liable for the surcharge. The method of pro-rating should be stated in the certificate.

3.5.2 Cases where this applies include:

- for the 1996-97 financial year, to reflect the fact that the surcharge did not take effect until 7.30 pm EST on 20 August 1996;

- where a member joins or exits a superannuation scheme during a financial year;

- where a member changes from an accruing to non-accruing member (or vice versa) during a financial year; and

- changes in the member's benefit category during a financial year.

3.6 Accumulation only benefits

3.6.1 Members of defined benefits superannuation schemes for whom there are separately defined and allocated contributions and who are entitled to receive an accumulation benefit only should be treated consistently with members of accumulation schemes.

4. Economic parameters

4.1 General

4.1.1 The economic parameters specified for use in calculation of the NSCF are intended only for that purpose and should not be assumed to be relevant for any other purpose.

4.2 Discount rates

4.2.1 The discount rate shall be the 10-Year Commonwealth Government Bond Rate as at the 30 June immediately preceding or coincident with the earlier of:

- the first reporting period for the certificate; or
- the date on which the certificate is prepared and signed by the actuary;

and rounded to the nearer ½ per cent per annum (where the fractional part of the rate is ¼ per cent or ¾ per cent the rate should be rounded up).

4.2.2 The discount rate is net of allowances for investment expenses and investment-related taxation.

4.2.3 The applicable discount rate for certificates in respect of the 1996-97 reporting period is 9 per cent per annum.

4.3 Rates of future salary or wages growth

4.3.1 The rate of salary or wages growth assumed for the purpose of projections should be equal to the discount rate specified in section 4.2 above, less 3½ per cent per annum.

4.3.2 If the discount rate as specified in section 4.2 is less than 3½ per cent per annum, the rate assumed for salary or wages growth is zero.

4.3.3 This rate should also be used where benefits increase in line with a general wage index such as AWE or AWOTE.

4.3.4 The applicable rate of salary or wages growth for certificates in respect of the 1996-97 reporting period is 5½ per cent per annum.

4.4 Rates of promotional salary growth

4.4.1 No separate salary promotional scale should be used in calculations of the NSCF.

4.5 Rates of increase in price indices

4.5.1 Where benefits are linked at some stages to the increase in a published price index, the rate of increase in such price indices for the purpose of projections should be equal to the discount rate specified in section 4.2 above, less 5½ per cent per annum.

4.5.2 If the discount rate as specified in section 4.2 is less than 5½ per cent per annum, the rate assumed for price index increases is zero.

4.5.3 The applicable rate of increase in a price index for certificates in respect of the 1996-97 reporting period is 3½ per cent per annum.

5. Other parameters

5.1 Definition of salary

5.1.1 Subsection 8(3) of the Act specifies the annual salary to which the NSCF is to be applied as:

“(a) if paragraph (b) does not apply - the amount that is the member’s annual salary for the financial year; or

(b) if another amount is taken to be the member’s annual salary for the purposes of the scheme as it applies to the member for the financial year - that other amount.”

5.1.2 The actuary should state the definition of salary to be used in calculating the surchargeable contributions and ensure that it is consistent with the NSCF provided in the certificate.

5.1.3 In the event that a scheme benefit structure is not salary-based, the actuary may specify an amount in the certificate so that, for the purpose of the Act, the NSCF is that amount divided by the annual salary however determined. Alternatively, it is acceptable for the actuary to specify the mechanism for calculating the actual amount of surchargeable contributions.

5.2 Rates of decrement and other parameters

5.2.1 The decrement rates used for the determination of the NSCF should be those adopted at the most recent actuarial valuation which:

(i) was prepared for SIS purposes; and

(ii) has a valuation date prior to or coincident with the start of the financial year to which the certificate first applies.

5.2.2 Other parameters required should be those adopted at the most recent actuarial valuation (as defined in paragraph 5.2.1).

5.2.3 Where the actuary considers that the assumptions adopted at the most recent valuation (as defined above) are no longer appropriate, due to a major change in the scheme (such as a merger), the assumptions used for certificate purposes should refer back to the relevant prior valuations.

5.2.4 Where a new scheme has not yet had an actuarial review, the actuary should use assumptions consistent with a comparable scheme. In this case, a replacement certificate should be prepared within twelve months of the first actuarial review.

5.2.5 Superannuation Guarantee minimum benefits should be assumed to increase in accordance with the contributions schedules in the *Superannuation Guarantee (Administration) Act 1992*.

5.3 Benefit options

5.3.1 Where the superannuation scheme offers a choice of benefits on exit, the actuary should use the same assumptions as were adopted in the most recent actuarial valuation (as defined in section 5.2 of this Attachment).

5.3.2 In particular, where it has been assumed in the most recent actuarial valuation that the benefit choice taken will always be the lower value option, this assumption should be used to calculate the NSCF. However, when an individual member selects a higher value option on exit, this should be treated as an augmentation of benefit at the time it is taken, and hence a notifiable event (see Part 6 below). In these circumstances, the difference between the value of the benefit option actually taken and that assumed in deriving the NSCF should be regarded as an augmentation and, hence, reportable in the year in which the benefit is taken.

5.4 Discretionary benefits

5.4.1 Where some element of benefits is provided at the discretion of the scheme trustees, or the sponsor of the plan, the actuary should use the same assumptions as were adopted in the most recent actuarial valuation (as defined in section 5.2 above).

5.4.2 If no allowance was made for discretionary benefit improvements in the most recent actuarial valuation, any difference between the value of the benefit actually provided and that assumed in deriving the NSCF should be considered a benefit augmentation and hence constitute a notifiable event (see Part 6 below). Such a benefit augmentation is reportable in the year in which the benefit is taken.

5.5 Death and disability benefits

5.5.1 The cost of death, disability and related risk benefits is to be incorporated in the calculation of the NSCF.

5.5.2 The cost should be calculated as the equivalent one year insurance cost of the future service component of the benefits.

5.5.3 Where a non-zero assumption for death and disability rates was made at the previous valuation (as defined in section 5.2 above), the cost of death and disability cover should be based on the valuation assumptions.

5.5.4 Where no assumption was made or a nil assumption was made at the last valuation or there has been no previous valuation, the decrement rates for death and disability published by the Institute of Actuaries of Australia for the purpose of the defined benefit formula for minimum requisite benefit determinations should be used. These decrement rates were published in the *Quarterly Journal of the Institute of Actuaries of Australia*, June 95 (pages 40-47).

5.6 Expenses

5.6.1 Scheme administration costs (excluding investment expenses) are to be incorporated in the calculation of NSCF at the rate assumed at the last valuation (as defined in section 5.2 above).

5.6.2 Where there has been no previous valuation, scheme administration costs (excluding investment expenses) should be assumed to be equal to ½ per cent of annual salaries.

5.7 Contributions tax

5.7.1 The NSCF should be adjusted to reflect the application of the full scale (15 per cent) contributions tax (net of administration expenses and insurance deduction offsets).

5.7.2 This is the case even if the scheme is not paying the full 15 per cent tax rate due, for example, to tax losses brought forward or to full offset by Funding Credits.

5.8 Benefit adjustments for the surcharge

5.8.1 If an employer agrees to absorb the cost of the surcharge, in whole or part, the actuary should specify that an additional amount equal to the value of the absorbed surcharge divided by 0.85 should be added to the contribution otherwise reported to the ATO in that year.

5.9 Benefits provided on payment of lump sum amounts into the scheme

5.9.1 Where a superannuation scheme receives amounts in respect of a member (such as an eligible termination payment from another scheme), any difference between the value of the benefit actually provided in respect of the amount transferred into the scheme and the transferred amount should be considered a benefit augmentation and hence constitute a notifiable event (see Part 6 of this Attachment).

6. Notifiable events

6.1 Notifiable events fall into two categories:

- events which are foreseen as possibilities at the time the certificate is prepared and which can be handled by a process specified in the existing certificate (which may be specified in detail or may involve reference to the actuary at the time the event occurs); and

- events unanticipated at the time the certificate is prepared and which require the replacement of the certificate.

6.2 Where an anticipated notifiable event occurs, the action specified in the certificate should be followed and there is no requirement for a new certificate to be prepared. For example, where there is an expectation that benefits could be augmented, the certificate may specify that such augmentations are to be considered as contributions in the year in which they occur.

6.3 An unanticipated event, such as the alteration of the benefit structure, requires the preparation of a new certificate. Where the assumptions from the most recent valuation (as defined in section 5.2 above) are no longer appropriate, the actuary should make necessary modifications.

7. The certificate

7.1 General

7.1.1 NSCF advice should take the form of a certificate advising the superannuation scheme of the rate or rates which should be applied, how they should be applied to determine contribution amounts, and any other conditions on the application of the certificate.

7.1.2 Calculations may be made on the basis of each new member year of age and, if appropriate, at each year of duration of future service or any other appropriate membership characteristics.

7.2 Content of the certificate

7.2.1 The certificate should set out:

- the commencement and expiry dates of the certificate:
  - ◊ the actuary can determine these dates but the duration of the certificate cannot exceed five years. The certificate cannot be signed and dated by the actuary more than 12 months ahead of commencement of the first reporting period to which it is to be applied;
- the name and qualifications of the certifying actuary;
- the name of the superannuation scheme;
- the identification of non-accruing and accruing categories for NSCF purposes (see section 3.3 of this Attachment);
- the definition of salary for the purposes of the certificate, including the treatment of members whose salary for the purposes of the certificate is adjusted during the reporting period if applicable (see section 5.1 of this Attachment);
- the treatment of members who join the scheme part way through the reporting period, if applicable;
- the treatment of members who become eligible to leave the scheme, and for members who receive their benefits during the reporting period;

- the treatment of members who change from one category to another during the reporting period (particularly from an accruing category to a non-accruing category - see section 3.3 of this Attachment);
- the assumptions adopted in calculating the NSCF;
- the notifiable events which require specified action or replacement of the certificate; and
- the table of NSCF in which:
  - ◊ rates should be expressed as percentages and rounded to the nearer 1/10th of one per cent; and
  - ◊ all periods should be expressed in whole years rather than any shorter period.

7.3 Replacement of the certificate

7.3.1 The completion of an actuarial review subsequent to the review used for the preparation of the certificate (as defined in section 5.2 of this Attachment) requires the preparation of a new certificate within 2 years of the valuation date of the subsequent review.

7.3.2 An unanticipated notifiable event also requires replacement of the certificate.