TD 2014/7 - Income tax: in what circumstances is a bank account of a complying superannuation fund a segregated current pension asset under section 295-385 of the Income Tax Assessment Act 1997 ?

Taxation Determination

Income tax: in what circumstances is a bank account of a complying superannuation fund a segregated current pension asset under section 295-385 of the *Income Tax Assessment Act 1997*?

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If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is 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.

Ruling

1. An account offered by banks or similar financial institutions (which are referred to here generally as banks) is an asset of a complying superannuation fund that is invested, held in reserve or otherwise being dealt with solely to enable, or for the sole purpose of enabling, a fund to discharge liabilities payable in respect of superannuation income stream benefits payable by the fund at that time ('the relevant sole purpose'), where the whole of the account is so invested, held or dealt with.[1]

[1] Subject to subsections 295-385(5) and (6) of the ITAA 1997, an asset held for the relevant sole purpose will be a segregated current asset when the additional requirements of paragraphs 295-385(3)(b) or 295-385(4)(b) are met.

2. It is recognised that some banks offer what are commonly referred to as 'sub-accounts'.[2] Where all transactions and balances are recorded, maintained and reported on a sub-account basis, then a sub-account held for the relevant sole purpose may be a segregated current pension asset for the purposes of section 295-385 of the ITAA 1997. This is the case even if other sub-accounts within the higher-level account are not held for the relevant sole purpose.

3. This interpretation applies to actual sub-accounts which are formally maintained by banks, and also to informal or notional sub-accounts where proper accounting records are maintained by other non-bank parties (for example, a trustee of a superannuation fund).

4. Some receipts or outgoings[3] that require apportionment between liabilities in respect of superannuation income stream benefits payable by a fund at that time and other liabilities[4] will of necessity be paid to or from a single bank account. Where such amounts are paid in a bona fide manner to or from a segregated current pension asset, being the segregated bank account, in order to maintain segregation of the bank account the Commissioner will require the fund to make a transfer or set off (equal to the value of the receipt or outgoing that does not relate to the fund's liability to meet its superannuation income stream benefits payable at that time) between the fund's segregated bank account and another bank account within a reasonable time.

5. When interest income is derived on amounts that were paid to a bank account that is a segregated current pension asset in the above circumstances, then any interest that is attributable to the amount required to be transferred or set off as explained above is taken not to have been earned by the segregated current pension asset.

6. There may be cases in which a superannuation contribution is made in error to a bank account or recorded against the incorrect sub-account and that particular bank account or sub-account is a segregated current pension asset. The amount of the superannuation contribution must be transferred to the correct bank account or sub-account within a reasonable time. Any interest income that is earned on that superannuation contribution is taken not to be attributable to the segregated current pension asset, and would not form part of any exempt income under section 295-385 of the ITAA 1997.

7. Some essential incidental expenses[5] payable by a complying superannuation fund may relate to the operation of the fund generally and might not be subject to apportionment. Payment of such essential incidental expenses from a segregated bank account will not prevent the account from being a segregated current asset held for the relevant sole purpose.

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[2] Subregulations 20(5) and (6) of the *Banking Regulations 1966* refer to 'sub accounts'. These two provisions form part of the rules regarding unclaimed money. 'Sub account' in that sense refers to an account that is part of another account, and operated and maintained as such.

[3] For example, a taxation refund or a taxation payment, or a dividend paid by a company in respect of which some of the shares held are segregated current pension assets and some are not.

[4] That is, current pension liabilities, being liabilities (contingent or not) in respect of superannuation income stream benefits that are payable by the fund at a time, as distinguished from all other liabilities.

[5] An expense will be incidental if it has a relatively minor role and quantum in relation to the role of discharging or enabling the fund to meet its liabilities in respect of superannuation income stream benefits.

Example 1: Segregated bank account and general bank account maintained

8. A complying superannuation fund has a bank account with a balance of approximately $100,000 from time to time, and a one year term deposit with a balance of $200,000. Both the term deposit and bank account hold monies and are invested solely to enable the fund to discharge liabilities in respect of the superannuation income stream benefits for two of its members.

9. The fund holds another bank account with a balance of $250,000 in respect of the superannuation benefits of one other member who is yet to retire and is still in the accumulation phase.

10. The fund also holds a real property rented as commercial premises, and shares in listed companies.

11. The records of the trustee of the fund record the purpose for which each bank account, the term deposit, the real property, and the shares are held. The accounting records and financial statements of the fund also deal with them on the basis that they are held for different purposes.

12. Each bank account and the term deposit can be treated as separate assets. As separate bank accounts are maintained to discharge liabilities in respect of superannuation income stream benefits payable by the fund at that time and for the other liabilities of the fund, the term deposit and bank account supporting the liabilities in respect of superannuation income stream benefits are segregated current pension assets for the purposes of section 295-385 of the ITAA 1997 (subject to subsections 295-385(5) and (6), and where the additional requirements of paragraphs 295-385(3)(b) or 295-385(4)(b) are met).

Example 2: Sub-accounts within pooled bank account

13. A large complying superannuation fund operates a member directed platform investment service, allowing members to choose the investments that are allocated to their specific superannuation member account.

14. As part of this service, the fund maintains a pooled bank account held by the superannuation fund trustee for the benefit of all members. Each member is assigned a sub-account with the balance in that sub-account representing their share of the pooled bank account balance.

15. The superannuation fund's accounting software allows each sub-account to be segregated between each member, and differentiates between the sub-accounts of members in accumulation phase (accumulation members) and those who currently receive superannuation income stream benefits (pension members).

16. The software attributes the dollar value of individual transactions to each member's sub-account and calculates interest income based on each member's sub-account daily balance. Each sub-account allocated to a pension member thereby supports the superannuation income stream benefits payable by the fund to the member at that time.

17. As a result, the sub-account allocated to each pension member by the superannuation fund's accounting software will be a segregated current pension asset[6].

[6] Subject to subsections 295-385(5) and (6), and where the additional requirements of paragraphs 295-385(3)(b) or 295-385(4)(b) are met.

Example 3: Change from accumulation phase to benefit phase

18. A complying superannuation fund has one bank account with a balance of approximately $750,000 from time to time, maintained for its only two members, both of whom have been in accumulation phase. $350,000 relates to Member X and $400,000 relates to Member Y. The superannuation fund has other assets.

19. Member X reaches retirement age and elects to be paid a superannuation income stream and receives superannuation income stream benefits.

20. Although the bank does not formally provide separate sub-accounts, the trustees of the fund effectively create an informal sub-account by maintaining accurate accounting records, and are able to identify at any point in time which portion of the bank account balance supports the new superannuation income stream payable by the fund at that time.

21. As a result, the new informal sub-account (initially with a balance of $350,000) supporting the superannuation income stream benefit payable by the fund will be a segregated current pension asset.[7]

Example 4: Dividend payment to segregated bank account, and transfer of part of the amount to general bank account within a reasonable time

22. A complying superannuation fund has two bank accounts. Bank Account 1 is a segregated current pension asset and as such is used to meet the liabilities in respect of superannuation income stream benefits payable by the fund at that time. Bank Account 2 is held in respect of all other liabilities.

23. The fund holds 10,000 shares in QRS Ltd, of which 3,000 are segregated current pension assets. The shares are uncertificated and the fund is the registered shareholder on the stock exchange electronic sub-register maintained by QRS Ltd. The fund keeps appropriate records to identify and trace the 3,000 segregated shares and the other 7,000 shares.

24. QRS Ltd pays a dividend of $1 per share, and makes a single payment of $10,000 to Bank Account 1 by electronic funds transfer in respect of the 10,000 shares held by the fund.

25. The fund transfers $7,000 to Bank Account 2 as soon as practically possible after receiving the dividend. It also transfers an additional $7 representing interest which had accrued in respect of the $7,000. As $7,007 was transferred from Bank Account 1 to Bank Account 2 within a reasonable time in the circumstances, the Commissioner accepts that Bank Account 1 will continue to be a segregated current pension asset.

26. As the Commissioner does not accept that the $7 interest was income properly attributable to a segregated current pension asset, that amount of interest would not form part of any exempt income under section 295-385 of the ITAA 1997.

[7] Again, subject to subsections 295-385(5) and (6), and where the additional requirements of paragraphs 295-385(3)(b) or 295-385(4)(b) are met.

Example 5: Error in payment made to a segregated bank account, rectified within a reasonable time

27. A complying superannuation fund has several hundred bank accounts. Approximately half of the accounts relate to members in accumulation phase while the remaining accounts are segregated current pension assets and relate to members currently in receipt of superannuation income stream benefits.

28. A new member joins the fund and makes an initial superannuation contribution of $10,000.

29. Due to an administrative error by the fund, the superannuation contribution is credited to an existing account [Account 1, a segregated current pension asset] belonging to a member who currently receives superannuation income stream benefits.

30. A short time later, during which the contribution has earned $10 in interest, the fund realises the error and creates an account [Account 501] for the new member. The fund immediately transfers $10,010 (representing the amount of the contribution plus accrued interest) to the newly created account.

31. As the amount in question was transferred between the relevant accounts within a reasonable time in the circumstances, the Commissioner accepts that Account 1 will continue to be a segregated current pension asset.

32. Similar to Example 4, the amount of $10 interest would not form part of any exempt income under section 295-385 of the ITAA 1997.

33. This would equally apply to any situation where a bank provided sub-accounts and the amounts were transferred from an incorrect sub-account to the correct sub-account.

Example 6: Incidental payments from a segregated bank account

34. A complying superannuation fund has two members, both of whom have retired and are receiving superannuation income stream benefits from the fund. Among other assets, the fund holds a single bank account, being a segregated current pension asset which is used to discharge the liabilities for superannuation income stream benefits payable by the fund at that time.

35. The fund makes necessary incidental payments (such as for its annual supervisory levy) from that bank account.

36. As such payments are both incidental and necessary, the bank account is still being maintained for the relevant sole purpose, and remains a segregated current pension asset.

Date of effect

37. This Determination applies to income years commencing both before and after its date of issue. However, the Determination will 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 Determination (see paragraphs 75 to 76 of Taxation Ruling TR 2006 /10).

Commissioner of Taxation
9 April 2014

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.

Background: Exempt income under Subdivision 295-F

38. Subdivision 295-F of the ITAA 1997 provides that the ordinary and statutory income of a complying superannuation fund may be exempt from income tax in two different circumstances:

(i) where the income is derived from segregated current pension assets under section 295-385 (segregation); or

(ii) where the income is apportioned under section 295-390 ('apportionment').

39. Segregation and apportionment can both be applicable to exempt different amounts of income of a complying superannuation fund in the same income year. For example some assets might be segregated for the discharge of part of the liabilities in respect of income stream benefits under section 295-385 of the ITAA 1997, and a proportion of the income received from the remainder of the assets might be exempt in accordance with the apportionment calculation under section 295-390.

Segregation

40. Subsection 995-1(1) of the ITAA 1997 states that 'segregated current pension assets' has the meaning given by section 295-385 of the ITAA 1997, which has two definitions of the term in subsections 295-385 (3) and (4).

41. Both subsections 295-385(3) and (4) provide that assets are segregated current pension assets at a time if the assets are invested, held in reserve or otherwise being dealt with at that time for the sole purpose of enabling the fund to discharge all or part of its liabilities (contingent or not) as they become due, in respect of superannuation income stream benefits.[8] Each subsection has a respective different additional requirement, as follows:

(i) Subsection 295-385(3) applies where the trustee obtains an actuary's certificate before the date of lodgement of the fund's income tax return for the income year to the effect that the assets and the earnings expected to be made from them would provide the amount required to discharge in full all or part of the fund's liabilities (contingent or not) in respect of superannuation income stream benefits payable by the fund as they fall due.

[8] Although the wording of paragraph 295-385(3)(a) and subsection 295-385(4) is different in certain respects, these differences do not result in any differences in meaning or application between the two subsections.

(ii) Subsection 295-385(4) applies in respect of superannuation income stream benefits prescribed in the *Income Tax Assessment Regulations 1997* (three types have been prescribed: allocated pensions, market linked pensions, and account-based pensions, all within the meaning of the *Superannuation Industry (Supervision) Regulations 1994*)[9] that are payable by the fund at that time, subject to the exceptions in subsections 295-385(5) and (6).[10]

42. Subsection 295-385(4) applies when the liabilities of the fund are to pay only superannuation income stream benefits prescribed by the regulations for the whole income year and there are no liabilities to pay any other kind of superannuation income stream benefits. This requirement is clearly stated by subsection 295-385(5).

Apportionment

43. Where assets are not segregated under section 295-385 of the ITAA 1997, section 295-390 of the ITAA 1997 provides that a proportion of the income of a complying superannuation fund can be exempt from tax, calculated under a statutory formula based on the evidence of the fund's assets and liabilities stated in an actuary's certificate.

Bank account as an asset

44. The term 'asset' is not defined in the ITAA 1997 and therefore it takes its ordinary meaning having regard to the context in which it is used. [11] The *Macquarie Dictionary* (5th Edn) defines 'asset' to mean '*an item of property; an economic resource*'. Similarly, the *LexisNexis Concise Australian Legal Dictionary* (4th Edn) defines an asset to be:

> an item, whether tangible or intangible, having economic value to its owner which, if not already in the form of money, can be converted into money to the owner's benefit.

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[9] That is, as at the date of issue of this Determination: see regulation 295-385.01 of the *Income Tax Assessment Regulations 1997*.

[10] Subsection 295-385(5) of the ITAA 1997 requires that at all times during the income year the liabilities of the fund (contingent or not) to pay superannuation income stream benefits were liabilities in respect of prescribed superannuation income stream benefits. Subsection 295-385(6) provides that assets supporting a superannuation income stream benefit prescribed by the regulations are not segregated to the extent that the market value of the assets exceeds the account balance supporting the benefit.

[11] Statutory definitions related to 'asset' are consistent with this approach. Under subsection 10(1) of the *Superannuation Industry (Supervision) Act 1993*: 'asset means any form of property and, to avoid doubt, includes money (whether Australian currency or currency of another country)' (See also the definition of 'acquirable asset' in section 67A of that Act). 'CGT asset' is defined in section 108-5 of the ITAA 1997 as 'any kind of property' or 'a legal or equitable right that is not property' and also includes part of an asset. Examples of CGT assets stated are 'land and buildings' and 'shares in a company and units in a trust'. See also SMSFR 2012/1.

45. The sole purpose requirement in subsections 295-385(3) and (4) of the ITAA 1997 also requires that the asset only be invested, held or otherwise dealt with for the relevant purpose, and not partly for any other purpose. In *Ryde Municipal Council v. Macquarie University*[12] Gibbs ACJ referred to the decision of Windeyer J in *Randwick Corporation v. Rutledge* (1959) 102 CLR 54 and approved the following statement from that case:

> When such words' [as 'exclusively' or 'solely'] 'are present, it is a question of fact whether the land is being used for any purpose outside the stipulated purpose… As Kitto J. said in *Lloyd v. Federal Commissioner of Taxation* (48), such words confine the use of the property to the purpose stipulated and prevent any use of it for any purpose, however minor in importance, which is collateral or independent, as distinguished from incidental to the stipulated use.

46. As an asset is required to be invested, held or otherwise dealt with for the sole purpose of discharging superannuation income stream benefit liabilities in terms of section 295-385 of the ITAA 1997, it is not possible to meet this requirement if an asset, and the income from that asset, serves more than that sole purpose.

47. It is a long accepted and established interpretation that a deposit with a bank is a single loan from the customer to the bank.[13] The balance of the money in the bank account standing to the customer's credit is an accruing debt that the bank owes to the customer [14] that arises out of one continuing contract between the customer and the bank.[15] Where deposits have been made to an account over time they form one blended fund, the parts of which have no longer any distinct existence.[16] The bank is free to use the money as its own and, once deposited, the customer has parted with all control over the money.[17]

48. A further complicating factor is that in calculating the amount of the debt owing between bank and customer, the bank may be entitled to combine the amounts when a customer has more than one bank account with that bank. This is known as the 'right of combination'.[18] Accounts can be combined even if they are kept at different branches of the same bank.

49. Some bank accounts are used for a range of different purposes. These bank accounts are characterised by numerous transactions with a constant flow of funds into and out of the account. In the context of a superannuation fund, transactions include accepting the proceeds received on the disposal of superannuation fund assets and paying for the purchase of other assets by the fund. Monies held within an account would also be used to meet superannuation fund expenses and for paying superannuation benefits. Other functions of these accounts can include accepting superannuation contributions from members.

50. One important characteristic that distinguishes bank accounts from other assets is that such an asset can easily be divided into smaller assets with the result being that each of the smaller assets is of the same nature as the original asset. e.g. for the purposes of segregation, a bank account with a total balance of $100 and with notional sub-accounts of $70 and $30 is effectively the same as two separate bank accounts with balances of $70 and $30.

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[12] (1978) 139 CLR 633; (1978) 53 ALJR 179; (1978) 55 LGRA 373; (1978) 23 ALR 41; [1978] HCA 58.
[13] *Parker v. Marchant* (1843) 1 PH 356.
[14] *Walker v. The Bradford Old Bank Ltd* (1884) 12 QBD 511.
[15] *Joachimson v. Swiss Bank Corp* [1921] 3 KB 110.
[16] *Devaynes v. Noble* (*Clayton's Case*) (1816) 1 Mer 529; (1816) 35 ER 781.
[17] In a superannuation context paragraph 105 of Taxation Ruling TR 2008/9 (meaning of 'Australian superannuation fund') noted that a bank account is a debt being a single chose in action.
[18] *Garnett v. M'Kewan* (1872) LR 8 Ex 10.

51. This aspect is a major consideration in the Commissioner adopting a practical approach to sub-accounts. When a bank provides sub-accounts for their customers these sub-accounts can be viewed as accounts in their own right. Legislative support for this view is provided by the *Banking Regulations 1966*. The amounts in each sub-account can be distinguished from amounts in another sub-account.

52. On that basis, each sub-account will be treated as a bank account for the purposes of section 295-385 of the ITAA 1997. The relevant sub-account can therefore be treated as a segregated current pension asset.

53. By analogy, the ATO accepts that notional or virtual sub-accounts, due to their particular nature, will be treated as sub-accounts – but only where proper accounting records are maintained.

54. Often large funds use sophisticated accounting software and this software will provide the necessary proper accounting records. They may also rely on actual sub-accounts that are provided by banks and then use the accounting software to create virtual or notional sub-accounts to distinguish between pension balances and accumulation balances for a particular fund member. Such an arrangement is also acceptable where proper accounting records are maintained.

55. In other cases the use of notional or virtual 'sub-accounts' would mean ensuring that transactions and balances are clearly recorded and reported so that amounts in a notional 'sub-account' can be readily determined. Such a sub-account can be a segregated current pension asset.

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

SMSFR 2012/1; TR 2006/10; TR 2008/9

Previous Rulings/Determinations:

TD 2013/D7

Subject references:

- exempt income of superannuation funds
- segregated current pension assets
- superannuation fund income

Legislative references:

- TAA 1953
- ITAA 1997 108-5
- ITAA 1997 Div 295
- ITAA 1997 Subdiv 295-F
- ITAA 1997 295-385
- ITAA 1997 295-385(3)
- ITAA 1997 295-385(3)(a)
- ITAA 1997 295-385(3)(b)
- ITAA 1997 295-385(4)
- ITAA 1997 295-385(4)(b)
- ITAA 1997 295-385(5)
- ITAA 1997 295-385(6)
- ITAA 1997 295-390
- ITAA 1997 995-1(1)
- ITAR 1997 295-385.01
- SISA 1993 10(1)
- SISA 1993 67A
- SISR 1994
- *Banking Regulations 1966*

Case references:

- *Devaynes v. Noble* (1816) 1 Mer 529; (1816) 35 ER 781
- *Garnett v M'Kewan* (1872) LR 8 Ex 10
- *Joachimson v. Swiss Bank Corp* [1921] 3 KB 110
- *Parker v. Marchant* (1843) 1 PH 356
- *Randwick Corporation v. Rutledge* (1959) 102 CLR 54
- *Ryde Municipal Council v. Macquarie University* (1978) 139 CLR 633; [1978] HCA 58; (1978) 53 ALJR 179; (1978) 55 LGRA 373; (1978) 23 ALR 41;
- *Walker v. The Bradford Old Bank Ltd* (1884) 12 QBD 511

Other references:

- LexisNexis Concise Australian Legal Dictionary (4th Edn)
- Macquarie Dictionary (5th Edn)

ATO references

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