TD 2006/D3 - Income tax: will the Commissioner exercise his discretion under subsection 27H(3) of the Income Tax Assessment Act 1936 in determining the deductible amount in relation to a superannuation pension or 'eligible annuity' split pursuant to an agreement or court order on marriage breakdown?

This document has been finalised by TD 2006/34.

Draft Taxation Determination

Income tax: will the Commissioner exercise his discretion under subsection 27H(3) of the *Income Tax Assessment Act 1936* in determining the deductible amount in relation to a superannuation pension or 'eligible annuity' split pursuant to an agreement or court order on marriage breakdown?

This Ruling provides you with the following level of protection:

This publication is a draft for industry and professional comment. It represents the Commissioner's preliminary view about the way in which a taxation 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. You can rely on this publication (excluding appendices) to provide you with protection from interest and penalties in the way explained below. If a statement turns out to be incorrect and you under-pay your tax as a result, you will not have to pay a penalty. Nor will you have to pay interest on the under-payment provided you reasonably relied on the publication in good faith. However, even if you don't have to pay a penalty or interest, you will have to pay the correct amount of tax provided we are not prevented from doing so by a time limit imposed by the law.

Ruling

1. Yes. The Commissioner will exercise his discretion under subsection 27H(3) of the *Income Tax Assessment Act 1936* (ITAA 1936) in the manner set out below, where a superannuation pension or annuity payment is split in the way described in this Determination. If a taxpayer's circumstances do not fully come within this description, or they believe the Commissioner should exercise his discretion a different way, they should apply for a private ruling on how the discretion applies to their situation.

2. An arrangement to which this Determination applies will have the following features:

- A superannuation agreement or court order is made on marriage breakdown in accordance with Part VIIIB of the *Family Law Act 1975*.
- Pursuant to that superannuation agreement or Court order a 'superannuation pension' or 'eligible annuity' that has commenced to be paid to a 'member spouse' (the original pension or annuity) is to be split on a specified percentage basis in accordance with section 90MJ of the *Family*

Law Act 1975. 'Superannuation pension' and 'eligible annuity' have the meaning[1] which applies to those terms in section 140M of the ITAA 1936.

- The rules of the relevant fund or contract do not allow the original pension or annuity to be commuted.
- Paragraph (a) of the definition of 'undeducted purchase price' in section 27A of the ITAA 1936 does not apply to the original pension or annuity.[2]
- The pension or annuity payable to the member spouse after the split will not revert on the death of the member spouse to someone other than the non-member spouse.

3. The discretion in subsection 27H(3) of the ITAA 1936 will be exercised in the following way where the relevant number in the formula in subsection 27H(2) of the ITAA 1936 otherwise applicable in relation to the original pension is still appropriate. The relevant number will be appropriate where the terms and conditions of the annuity do not change as a consequence of the marriage breakdown. This method is simply to split the deductible amount calculated in relation to the original pension or annuity between the member spouse (MS) and the non-member spouse (NMS) in the same proportion as the payment split. This method can be represented by the following formula:

Deductible amount non-member spouse (DA NMS) = Original DA $\times$ NMS%

Deductible amount member spouse (DA MS) = Original DA - DA NMS

Original DA is the deductible amount of the original annuity

NMS% is the percentage of each original annuity payment that the NMS is entitled to receive under the payment split.

Example 1

4. *Rex commenced a lifetime superannuation pension on 1 July 2000 when he was 60. The UPP was $20,000 and there was no residual capital value. The relevant number was 20.05. The deductible amount of the pension each year was $998. Rex and Martha divorce and as the rules of the superannuation fund do not allow the pension to be commuted they agree to split the pension payments effective from 1 July 2004. Under the terms of the superannuation agreement Martha (the NMS) is to receive 45% of each pension payment and Rex (the MS) is to receive 55% of each pension payment. The deductible amount of Martha's new pension is:*

Original DA $\times$ *NMS%*

= $998 $\times$ *45%*

= $449

[1] 'Superannuation pension' is defined in section 140C of the ITAA 1936 and 'eligible annuity' is defined in section 90MD of the *Family Law Act 1975.*

[2] Paragraph (a) of the definition of 'undeducted purchase price' in section 27A applies to: (a) pensions or annuities first payable before 1 July 1994; or (b) annuities or pensions first payable on or after 1 July 1994 where: (i) the pension or annuity is not rebatable; or (ii) where a notice under section 159SS was given in relation to any payment of a rebatable superannuation pension during any year of income; or (iii) the pension or annuity is purchased on or after 1 July 1994 with one or more underlying commutation ETPs (representing the commutation or residual capital value of an annuity or pension which commenced before 1 July 1994).

The deductible amount of Rex's new pension is:

Original DA - DA NMS

= $998 - $449

= $549

5. However, the method in paragraph 3 of this Determination will not be appropriate where the terms and conditions of the pension change as a consequence of the marriage breakdown so that the relevant number applicable in relation to the original pension is no longer appropriate. This is most likely to occur where the original pension was reversionary and subsequent to the marriage breakdown the pension ceases to be reversionary so that the pension ceases on the death of the member spouse. If the life expectancy of the member spouse is less than that used as the relevant number in the original calculation of the deductible amount then a different relevant number will need to be used in calculating the deductible amount of the new pensions.

6. This method will recalculate the deductible amount of the original pension using the relevant number at the commencement day of the original pension assuming that the circumstances that exist immediately following the split had existed as at the commencement day of the original pension.

Example 2

7. *Luke commenced a superannuation pension payable for life on 1 July 1999. He is the member spouse (MS). Under the governing rules of the fund, the pension reverts to Luke's wife on his death. Luke was 55 when he commenced the pension and his wife, Angela was 50. The UPP was $100,000 and residual capital value was $0. The relevant number reflecting Angela's life expectancy was 32.32. The deductible amount of the pension was $3094.*

Luke and Angela divorce and as the rules of the fund do not allow the pension to be commuted they agree to split the pension payments effective from 1 July 1994. Under the terms of the superannuation agreement Angela is to receive 60% of each pension payment and Luke is to receive 40% of each pension payment. Angela is the non-member spouse (NMS).

However, under the governing rules of the fund the pension will no longer revert to Angela on Luke's death because of the divorce. Hence the existing relevant number based on Angela's life expectancy is no longer appropriate. The life expectation factor to be used as the relevant number is that for Luke as at the commencement day of the original pension which is 23.13.

The deductible amount of Angela's new pension is:

Recalculated DA = ($100,000 - 0)/23.13

= $4,323

DA NMS – Angela = Recalculated deductible amount × NMS%

= $4,323 × 60%

= $2,593

The deductible amount of Luke's new pension is:

DA MS - Luke = Recalculated DA - DA NMS

= $4,323 - $2,593

= $1,730

Date of effect

8. When the final Determination is issued, it is proposed to apply 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 21 and 22 of Taxation Ruling TR 92/20).

Commissioner of Taxation
18 January 2006

Appendix 1 – Explanation

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

Explanation

9. Subsection 27H(1) of the ITAA 1936 includes in assessable income the amount of any annuity received during the year, excluding the deductible amount. Subsection 27H(4) defines annuity to include a superannuation pension.

10. The deductible amount of an annuity is the amount calculated in accordance with the formula in subsection 27H(2) of the ITAA 1936. The formula calculates the deductible amount by dividing that part of the purchase price of the annuity that has not attracted a tax deduction ('the undeducted purchase price') by the 'relevant number'.[3]

11. Where an annuity is payable for a specific number of years, the relevant number equals that specific number of years. Where the annuity is payable only during the lifetime of the annuitant, the relevant number is the number of years of the life expectation of that person. Where an annuity is not payable for a fixed term or over the annuitant's lifetime, the Commissioner is required to calculate the relevant number.

12. Under subsection 27H(3) of the ITAA 1936 if the Commissioner is of the opinion that the deductible amount calculated under subsection 27H(2) is 'inappropriate' having regard to the terms and conditions of the annuity and such other matters as the Commissioner considers relevant, the Commissioner may determine the deductible amount that applies. Under subsection 27H(3) the deductible amount is so much of the annuity as, in the opinion of the Commissioner, represents the undeducted purchase price having regard to:

- the terms and conditions of the annuity;
- any certificates of an actuary stating the extent to which in the opinion of the actuary the amount of the annuity derived by the taxpayer in the year of income represents the undeducted purchase price; and
- such other matters as the Commissioner considers relevant.

13. Part VIIIB of the *Family Law Act 1975* provides for the splitting of superannuation on marriage breakdown. Splitting of superannuation in the family law context applies in relation to the superannuation interest of a member spouse.

14. For the arrangement described in paragraph 2 of this Determination, paragraph 140M(1C)(g) of the ITAA 1936 provides that, the payer is taken to have commenced to make payments of another superannuation pension or annuity to the member spouse. Paragraph 140M(1A)(e) of the ITAA 1936 provides that the payer is also taken to have commenced to pay a superannuation pension or annuity to the non-member spouse.

15. On the basis that section 140M of the ITAA 1936 deems there to be two new pensions to the member spouse and the non-member spouse, neither of which have been purchased, it is arguable that the deductible amount is nil for both pensions.

[3] Relevant number is defined in subsection 27H(4) of the ITAA 1936.

16. The definition of 'undeducted purchase price' (UPP) in subsection 27A(1) of the ITAA 1936 refers to the 'purchase price of the pension or annuity'. 'Purchase price' is defined in subsection 27A(1) as:

> (a) in relation to a superannuation pension – the sum of:
>
> > (i) contributions made by any person to a superannuation fund to obtain superannuation benefits; and
> >
> > (ii) so much as the Commissioner considers reasonable of contributions made by any person to a superannuation fund to obtain superannuation benefits including the superannuation pension...

17. A literal reading of the words in the above definition suggests that the new pensions now payable to the member spouse and the non-member spouse do not have a 'purchase price'. The contributions that have been made by 'any person' have been made to 'obtain superannuation benefits' consisting of the superannuation pension originally payable to the member spouse. On this basis no contributions have been made to purchase the pensions now being deemed to be paid to the member spouse and the non-member spouse. Hence there is no purchase price for either of the deemed two new pensions and the deductible amount is nil.

18. Alternatively, it could be argued that the member spouse is entitled to the entire UPP of the original pension. On this basis the member spouse would be entitled to the deductible amount as calculated for the original pension.

19. In the opinion of the Commissioner, using either a nil UPP for each new pension or allocating the entire UPP to the member spouse in applying the formula in subsection 27H(2) of the ITAA 1936 will produce an inappropriate result. It fails to meet the legislative intent of apportioning the taxed amount of the purchase price of the annuity stream over the term of the annuity payments. In addition it is not consistent with the scheme of section 27ACA of the ITAA 1936 which splits the 'undeducted contributions' element of certain eligible termination payments on the same proportional basis that applies under the Family Law agreement or court order.

20. Therefore, the Commissioner will exercise his discretion under subsection 27H(3) of the ITAA 1936 to determine the deductible amount applicable to each of the deemed new pensions having regard to primarily 'such other matters as the Commissioner considers relevant' as per paragraph 27H(3)(e).

Appendix 3 – Your comments

21. We invite you to comment on this draft Taxation Determination. Please forward your comments to the contact officer by the due date. (Note: The Tax Office prepares a compendium of comments for the consideration of the relevant Rulings Panel. The Tax Office may use a sanitised version (names and identifying information removed) of the compendium in providing its responses to persons providing comments. Please advise if you do not want your comments included in a sanitised compendium.)

Due date:	**17 February 2006**
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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 92/20

Subject references:

- deductible amount
- eligible annuity
- purchase price
- residual capital value
- superannuation
- superannuation pension
- undeducted purchase price

Legislative references:

- ITAA 1936 27A
- ITAA 1936 27A(1)
- ITAA 1936 27ACA
- ITAA 1936 27H(1)
- ITAA 1936 27H(2)
- ITAA 1936 27H(3)
- ITAA 1936 27H(3)(e)
- ITAA 1936 27H(4)
- ITAA 1936 140C
- ITAA 1936 140M
- ITAA 1936 140M(1A)(e)
- ITAA 1936 140M(1C)(g)
- Family Law Act 1975 Pt VIIIB
- Family Law Act 1975 90MD
- Family Law Act 1975 90MJ

ATO references

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