TD 2006/54 - Income tax: how does a taxpayer work out the amount to be included in assessable income under section 27H of the Income Tax Assessment Act 1936 for a superannuation pension or annuity that is payable in a foreign currency?

Taxation Determination

Income tax: how does a taxpayer work out the amount to be included in assessable income under section 27H of the *Income Tax Assessment Act 1936* for a superannuation pension or annuity that is payable in a foreign currency?

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Ruling

1. Superannuation pension or annuity payments derived by an Australian resident in a foreign currency are ordinary income under section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997).[1] However, the deductible amount in relation to the pension or annuity is excluded from assessable income under paragraph 27H(1)(a) of the *Income Tax Assessment Act 1936* (ITAA 1936). Therefore, the deductible amount represents an amount of ordinary income that is exempt income under subsection 6-20(2) of the ITAA 1997.[2]

[1] References to 'pension or annuity' in this Determination are limited to pensions or annuities to which paragraph 27H(1)(a) of the ITAA 1936 applies. The scope of section 27H is explained in paragraph 45 of this Determination.

[2] In addition to the amount excluded from assessable income under section 27H of the ITAA 1936, section 23AK of that Act may treat some or all of a pension or annuity paid from an eligible non-resident non-complying superannuation fund as non-assessable non-exempt income. This will happen if an amount has previously been included in a person's assessable income under the foreign income fund provisions (Part XI of the ITAA 1936) in respect of the person's interest in that fund.

2. Subsection 960-50(1) of the ITAA 1997 states that an amount in a foreign currency is to be translated into Australian currency. Subsection 960-50(4) of the ITAA 1997 further requires any foreign currency elements in a calculation to be translated before the final amount is worked out. This means that the foreign pension or annuity payments and the deductible amount each have to be translated before working out the assessable amount under section 27H of the ITAA 1936.

3. Item 6 of the table in subsection 960-50(6) of the ITAA 1997 provides that amounts of ordinary income are to be translated to Australian currency at the exchange rate applying at the time of receipt, unless the amount is derived before this time, in which case the amount is translated at the rate applying at the time of derivation.

4. As both the assessable and exempt parts of the pension or annuity payments are ordinary income, the same exchange rate will apply in translating the pension or annuity payments and the deductible amount.

5. As an alternative to the rate identified under item 6, item 12 of the table in subregulation 960-50.01(1) of the Income Tax Assessment Regulations 1997 (the Regulations)[3] states that an amount may be translated using any of the rules in Schedule 2 to the Regulations. Schedule 2 allows the average exchange rate for the income year to be used to translate the pension or annuity payments and the deductible amount if the conditions in subclause 1.3(2) of Schedule 2 to the Regulations are satisfied.

6. The steps set out at paragraphs 7 to 16 of this Determination immediately below must be followed to work out the assessable amount of foreign pension or annuity payments made during an income year under section 27H of the ITAA 1936.

Step 1 – Identify the deductible amount in foreign currency

7. The deductible amount for the foreign pension or annuity is worked out using the formula in subsection 27H(2) of the ITAA 1936. That subsection requires the deductible amount to be calculated by reference to the recipient's interest in the pension or annuity (the 'relevant share'), the undeducted purchase price of the pension or annuity, the residual capital value of the pension or annuity, and the number of years in the total period during which the pension or annuity will be, or may reasonably be expected to be, payable (the 'relevant number').

8. The undeducted purchase price and residual capital value used in this calculation are amounts worked out in the foreign currency, and can be determined when the pension or annuity is first derived.

Step 2 – Translation of the pension or annuity income in the income year

9. As set out in paragraphs 3 to 5 of this Determination, the foreign pension or annuity income for the income year must generally be translated at the time of receipt (or the time of derivation, if this is earlier) of the payments under item 6 of the table in subsection 960-50(6) of the ITAA 1997. As an alternative to the rates identified under item 6, item 12 of the table in subregulation 960-50.01(1) of the Regulations states that an amount may be translated using any of the rules in Schedule 2 to the Regulations. Schedule 2 allows the average exchange rate for the income year to be used to translate

[3] The table in subregulation 960-50.01(1), by its terms, modifies the general translation rule table in subsection 960-50(6) of the ITAA 1997.

the pension or annuity income if the relevant conditions in subclause 1.3(2) of Schedule 2 are satisfied.

10. The average exchange rate for the income year cannot be used for a pension or annuity received as a single annual amount during an income year. The conditions in subclause 1.3(2) of Schedule 2 to the Regulations will not be satisfied in these circumstances, and therefore the amount of pension or annuity income must be translated at the exchange rate applying when it is received (or when it is derived, if this is earlier) under item 6 of the table in subsection 960-50(6) of the ITAA 1997.

11. On the other hand, the average exchange rate for the income year may be used as an alternative to the rates identified under item 6 if a pension or annuity is received as a series of payments during an income year. Whether the conditions in subclause 1.3(2) of Schedule 2 to the Regulations are satisfied in these circumstances will depend on the number of payments that are made during the income year, the volatility of the applicable exchange rates during the income year and the relative amounts of each of the payments.

Step 3 – Translate the deductible amount

12. As the deductible amount represents that part of the pension or annuity income that is exempt ordinary income (as stated in paragraph 1 of this Determination), it must generally be translated using the exchange rate applying to the underlying pension or annuity income, under item 6 of the table in subsection 960-50(6) of the ITAA 1997.

13. Where the pension or annuity is received as a single annual amount during an income year, the deductible amount must therefore be translated at the exchange rate applying when the pension or annuity amount is received (or when it is derived if that is earlier).

14. Where each of a series of pension or annuity payments made over the course of an income year is translated under item 6 of the table in subsection 960-50(6) of the ITAA 1997, the deductible amount must be proportionately allocated to each payment made. The part of the deductible amount allocated to each payment must then also be translated under item 6 of the table in subsection 960-50(6) of the ITAA 1997 using the exchange rate applying to the payment to which it is allocated. The translated parts of the deductible amount would then be summed to work out the total translated deductible amount for the income year.

15. However, as an alternative, where the conditions in subclause 1.3(2) of Schedule 2 to the Regulations are satisfied and each of a series of pension or annuity payments made over the course of an income year is translated using an average exchange rate for the income year, the average rate may be used to translate the deductible amount as stated in paragraph 5 of this Determination.

Step 4 – Subtract the translated deductible amount from the translated pension or annuity income

16. The amount included in assessable income under section 27H of the ITAA 1936 is then determined by subtracting the result of step 3 from the result of step 2.

Practical application of steps 2 and 3

17. In many cases, a foreign pension or annuity received as a series of payments is deposited directly to a bank account denominated in Australian dollars. In these circumstances, the bank will translate each payment at an exchange rate applying at the time of deposit.

18. The daily exchange rates applied by the bank can be used to translate the pension or annuity payments under clause 1.2 of Schedule 2 to the Regulations. A pensioner or annuitant may therefore simply add up the amounts deposited to the bank account in applying step 2 above.

19. To reduce compliance costs involved in applying step 3 for pensioners or annuitants where this occurs, the Commissioner will, as a matter of administrative practice, accept a translation of the deductible amount using an average exchange rate for the income year, rather than requiring the deductible amount to be proportionally allocated to each payment and translated at the same rate applying to those payments. This approach will be acceptable whether or not the pensioner or annuitant knows the exchange rates used by the bank.

20. It is necessary for a pensioner or annuitant to satisfy the conditions in subclause 1.3(2) of Schedule 2 to the Regulations, as set out in paragraph 5 of this Determination, before the Commissioner will accept a translation of the deductible amount using an average exchange rate for the income year. The Commissioner may review the use of the average exchange rate for the deductible amount in these cases if it is clear that it is being chosen by the pensioner or annuitant for the purpose of reducing their taxable income.

Examples

21. *Each of the examples below is based on these common facts.*

22. *Bill is entitled to receive an annuity payment from England of £10,000 each year payable for 10 years. Bill is not a joint recipient of the annuity. The undeducted purchase price of the annuity is £80,000 and the annuity has no residual capital value.*

23. *Having regard to the formula in subsection 27H(2) of the ITAA 1936 and step 1 of working out the assessable amount under section 27H, described in paragraphs 7 and 8 of this Determination, the deductible amount will be calculated in the foreign currency as follows:*

$$\frac{\textit{Relevant Share} \times (\textit{Undeducted Purchase Price} - \textit{Residual Capital Value})}{\textit{Relevant number}}$$

$$1 \times (£80{,}000 - 0) \div 10$$

$$£8{,}000$$

Example 1 – The annuity is received as a single annual payment to an English bank account

24. *In this example, the annuity is paid as a single annual amount each year on 1 July. On 1 July 2006, the exchange rate is £1:$2.*

25. *As the annuity is payable as a single annual amount on 1 July 2006, the relevant amounts will be translated using the exchange rate applying on 1 July 2006. The average exchange rate for the income year cannot be used.*

26. *The annuity payment is translated using the 1 July 2006 exchange rate as follows:*

Amount received × exchange rate for 1 July 2006

£10,000 × $2/£1

$20,000

27. *The deductible amount calculated in pounds is then translated into Australian dollars using the same exchange rate as follows:*

Deductible amount × exchange rate for 1 July 2006

£8,000 × $2/£1

$16,000

28. *The assessable amount for the 2006-07 income year will therefore be worked out as follows:*

Amount received for year (A$) – deductible amount for year (A$)

$20,000 – $16,000

$4,000

Example 2 – The annuity is received as a series of payments to an English bank account

29. *In this example, the annuity is paid in 12 equal instalments on the first day of each month. For the 2006-07 income year, the average exchange rate is £1:$2.05.*

30. *As the annuity is payable in equal instalments every month throughout the income year, the relevant amounts may be translated using the average exchange rate applying for the 2006-07 income year.*

31. *The total annuity payment is translated using this average exchange rate as follows:*

Amount received × exchange rate for 2006-07 income year

£10,000 × $2.05/£1

$20,500

32. *The deductible amount calculated in pounds is then translated into Australian dollars using the same exchange rate as follows:*

Deductible amount × average exchange rate for 2006-07 income year

£8,000 × $2.05/£1

$16,400

33. *The assessable amount for the 2006-07 income year will therefore be worked out as follows:*

Amount received for year (A$) – deductible amount for year (A$)

$20,500 – $16,400

$4,100

Example 3 – The annuity is received as a single annual amount to an Australian dollar bank account

34. *In this example, the annuity is paid as a single annual amount each year on 1 July to a bank account denominated in Australian dollars. The bank translates the payment when it is deposited into the account. On 1 July 2006, the exchange rate applied by the bank is £1:$1.98.*

35. *The annuity payment is translated using the 1 July 2006 exchange rate applied by the Bank[4] as follows:*

Amount received × exchange rate for 1 July 2006

£10,000 × $1.98/£1

$19,800

36. *The deductible amount calculated in pounds is then translated into Australian dollars using the same exchange rate as follows:*

Deductible amount × exchange rate for 1 July 2006

£8,000 × $1.98/£1

$15,840

37. *The assessable amount for the 2006-07 income year will therefore be worked out as follows:*

Amount received for year (A$) – deductible amount for year (A$)

$19,800 – $15,840

$3,960

[4] As accommodated by clause 1.2 of Schedule 2 to the Regulations.

Example 4 – The annuity is received as a series of payments to an Australian dollar bank account

38. *In this example, the annuity is paid in equal instalments on the first day of each month to a bank account denominated in Australian dollars. The bank translates each payment to Australian currency on the date of deposit, but Bill does not obtain a record of the relevant translation rates. The amounts credited to the bank account total $19,950 for the 2006-07 income year and $19,100 for the 2007-08 income year. Bill wishes to treat these amounts as his total annuity income in Australian dollars for the relevant years.[5] For the 2006-07 income year, the average exchange rate is £1:$2.05. For the 2007-08 income year, the average exchange rate is £1:$1.90.*

39. *As Bill translates the annuity income using the daily exchange rates applied by the bank when the annuity income was deposited, he should generally use the same daily exchange rates to translate the foreign currency deductible amount. However, as a matter of administrative practice, the Commissioner will accept the use of the average exchange rate for the income year to translate the deductible amount, provided that the average exchange rate for the income year can be used as an alternative to translate the annuity income (in this case it can because of the equal payments made every month throughout the income year) and the average exchange rate for the income year is used in a manner that demonstrates that Bill is not seeking to reduce his taxable income through the choice of translation rates.*

2006-07 income year translations

40. The deductible amount can be translated using the average exchange rate applying for the 2006-07 income year as follows:

Deductible amount × average exchange rate for 2006-07 income year

£8,000 × $2.05/£1

$16,400

41. The assessable amount for the 2006-07 income year may then be worked out by subtracting the deductible amount from the total of the amounts credited to the Bill's bank account as follows:

Amount received for year (A$) – deductible amount for year (A$)

$19,950 – $16,400

$3,550

[5] As accommodated by clause 1.2 of Schedule 2 to the Regulations.

2007-08 income year translations

42. The deductible amount calculated in pounds can be translated into Australian dollars using the average exchange rate applying for the 2007-08 income year as follows:

$$\text{Deductible amount} \times \text{average exchange rate for 2007-08 income year}$$
$$£8{,}000 \times \$1.90/£1$$
$$\$15{,}200$$

43. The assessable amount for the 2007-08 income year may then be worked out by subtracting the deductible amount from the total of the amounts credited to the Bill's bank account as follows:

$$\text{Amount received (A\$)} - \text{deductible amount(A\$)}$$
$$\$19{,}100 - \$15{,}200$$
$$\$3{,}900$$

Date of effect

44. This Determination applies to years of income both before and after its date of issue. However the Determination 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 Determination; or
- the pension or annuity income was derived before 1 July 2003 for taxpayers whose 2003-2004 income year started on that date.[6]

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13 September 2006

[6] The currency translation rules in section 960-50 of the ITAA 1997 apply to transactions occurring on or after the first day of the 2003-04 income year or, if that day is earlier than 1 July 2003, occurring on or after the first day of the 2004-05 income year (see subsection 960-55(1) of the ITAA 1997). For taxpayers with income years not finishing on 30 June, this day will be the first day of the first income year commencing after 1 July 2003.

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.

Explanation

45. This Determination is concerned with annuities that are subject to section 27H of the ITAA 1936. Apart from payments that are annuities, as that term is ordinarily understood, the definition of 'annuity' in subsection 27H(4) extends to:

- a superannuation pension, that is, a pension payable from a fund, scheme or retirement savings account that is a superannuation fund as defined in subsection 27A(1) of the ITAA 1936; and
- a pension or annuity paid from a fund that is an eligible non-resident non-complying superannuation fund as defined in subsection 27A(1) of the ITAA 1936.

Section 27H is not concerned with an annuity that is a qualifying security for the purposes of Division 16E of Part III of the ITAA 1936.

46. This Determination has been drafted with the circumstances of individual pensioners and annuitants primarily in mind and will therefore be most relevant to these individuals. Although this Determination applies to a pension or annuity paid from an eligible non-resident non-complying superannuation fund, it does not explain how section 23AK of the ITAA 1936 may apply to make part of such a pension or annuity non-assessable non-exempt income. Section 23AK applies when an amount has previously been included in a person's assessable income under the foreign income fund provisions (Part XI of the ITAA 1936) in respect of the person's interest in that fund.[7]

47. Unless specifically excluded by the income tax law or impacted upon by the terms of a double tax agreement, a foreign pension or annuity received by an Australian resident will be taxable in Australia. Subsection 27H(1) of the ITAA 1936 includes in a person's assessable income the amount of a pension or annuity derived in an income year, excluding the 'deductible amount' for that pension or annuity. The deductible amount represents a portion of the 'undeducted purchase price' of the pension or annuity.

48. A pension, of necessity, consists of a series of periodic payments, which are generally made in consideration of past services, injury or loss sustained, merit, poverty or the relinquishment of rights, claims or emoluments.[8] A superannuation pension, which is expressly included within the scope of section 27H of the ITAA 1936, is generally a type of pension relating to the past services of the pensioner. Pensions are clearly a class of receipt of an income character.[9]

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[7] To find out how section 23AK of the ITAA 1936 applies, see the *Foreign investment funds guide* which can be found at www.ato.gov.au.

[8] *Tubemakers of Australia Limited v. Federal Commissioner of Taxation* 93 ATC 4207 at 4212; (1993) 25 ATR 183 at 189 per Hill J.

[9] *Federal Commissioner of Taxation v. Harris* 80 ATC 4238 at 4243; (1980) 10 ATR 869 at 874 per Bowen CJ.

49. On the other hand, an annuity is an investment where, in return for paying a capital sum, a party is entitled to receive periodic amounts over a number of periods.[10] Instalments of an annuity also have an income character.[11]

50. It is therefore clear that pension or annuity income subject to section 27H through paragraph 27H(1)(a) of the ITAA 1936 is ordinary income. The deductible amount, being the amount of the pension or annuity excluded from assessable income under section 27H, is therefore an amount of ordinary income that is exempt income under subsection 6-20(2) of the ITAA 1997.

51. The deductible amount for a pension or annuity is determined for an income year. It is generally determined by applying the formula in subsection 27H(2) of the ITAA 1936.[12]

52. Two of the key components of this formula are the undeducted purchase price of the pension or annuity and its residual capital value:

- In broad terms, the 'undeducted purchase price' is so much of the purchase price of the pension or annuity for which no deduction or rebate has been claimed or is claimable – subsection 27A(1) of the ITAA 1936.
- The 'residual capital value' of a pension or annuity is the capital amount payable on termination of the pension or annuity – subsection 27A(1) of the ITAA 1936.

53. The other components of the formula are the 'relevant share' and the 'relevant number'. The relevant share is commonly 1, but will be less where the pension or annuity is payable to two or more persons together during the income year – subsection 27H(4) of the ITAA 1936. The relevant number represents the term over which the pension or annuity will or may reasonably be expected to be payable – subsection 27H(4) of the ITAA 1936.

54. Subsection 960-50(1) of the ITAA 1997 states that an amount in a foreign currency is to be translated to Australian currency. Any pension or annuity paid in a foreign currency to which section 27H of the ITAA 1936 applies must therefore be translated to Australian currency.

55. Further, subsection 960-50(4) of the ITAA 1997 requires an amount that is an element in the calculation of another amount to be translated before working out the other amount. This means that the pension or annuity income derived in a particular income year and the deductible amount must be translated before working out the assessable amount under section 27H of the ITAA 1936.

56. The table in subsection 960-50(6) of the ITAA 1997 explains how foreign currency amounts are to be translated. Item 6 of the table indicates that an amount of ordinary income, such as pension or annuity income, should be translated at the exchange rate that applies when the income is received or when it is derived if receipt occurs after derivation.

57. The Commissioner considers it is most unlikely for pensioners or annuitants who are individuals to be accounting on an accruals basis. Therefore, the time of receipt is most likely to be the translation time under item 6 for these pensioners or annuitants. The rest of the Explanation section in this Determination assumes that the pensioner or annuitant accounts on a cash basis.

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[10] *Butterworth's Australian Legal Dictionary*, p.57; *Australia & New Zealand Savings Bank Ltd v. Federal Commissioner of Taxation* (1993) 42 FCR 535; 93 ATC 4370 at 4392; (1993) 25 ATR 369.
[11] *Australia & New Zealand Savings Bank Ltd v. Federal Commissioner of Taxation* (1993) 42 FCR 535 at 563; 93 ATC 4370 at 4392; (1993) 25 ATR 369 at 395 per Hill J.
[12] If the amount worked out on this basis is inappropriate, the Commissioner has discretion to determine a different deductible amount under subsection 27H(3) of the ITAA 1936.

58. The Commissioner considers item 6 to be relevant to the translation of both the pension or annuity income and the deductible amount. The pension or annuity income derived remains ordinary income notwithstanding some part of it (represented by the deductible amount) is excluded from assessable income.[13]

59. The calculation of the assessable amount for a foreign pension or annuity can therefore be explained as a four-step process.

Step 1 – Calculate the deductible amount in the foreign currency

60. The deductible amount is calculated for each income year. The components of the deductible amount formula in subsection 27H(2) of the ITAA 1936 (see paragraphs 52 and 53 of this Determination) are known when the pension or annuity first becomes payable.

Step 2 – Translate the pension or annuity income

61. When pension or annuity income is received in a single annual amount each income year, that income must be translated at the exchange rate that applies on that day.

62. When pension or annuity income is received as a series of payments through the income year, each receipt must generally be translated using the exchange rate that applies on the day of each receipt.

63. Alternatively, a person may choose to translate the total of the foreign currency payments for the year using the average exchange rate applicable for the income year. This is allowed by subsection 960-50(8) of the ITAA 1997 and subregulation 960-50.01(1) of, and Schedule 2 to, the Regulations, provided that the three conditions in subclause 1.3(2) of Schedule 2 to the Regulations are satisfied. The conditions are discussed in paragraphs 64 to 66 of this Determination.

64. First, it must appear reasonable to the pensioner or annuitant making the translation that the average rate would be a reasonable approximation of the exchange rates that would have applied if each instalment of the pension or annuity income had been translated separately – paragraph 1.3(2)(a) of Schedule 2 to the Regulations. Whether this condition will be satisfied will depend on the facts and circumstances of each case. Factors that need to be taken into account include the number of payments that are made during the income year, the volatility of the applicable exchange rates during the income year, the relative amounts of each of the payments involved, and whether payments are made at regular periods through the income year.

65. Secondly, the pensioner or annuitant must obtain the average exchange rate from a source that is not an associate – paragraph 1.3(2)(b) of Schedule 2 to the Regulations. This condition will be satisfied if the average exchange rates published by the Commissioner are used.[14]

66. Thirdly, the average rate for the relevant period must be used – paragraph 1.3(2)(c) of Schedule 2 to the Regulations. In this case, the relevant period is the income year.

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[13] See *Australia & New Zealand Savings Bank Ltd v. Federal Commissioner of Taxation* (1993) 42 FCR 535 at 563; 93 ATC 4370 at 4392; (1993) 25 ATR 369 at 395 per Hill J and subsections 6-5(1), 6-10(1), 6-10(2) and 6-20(2) of the ITAA 1997.
[14] These can be found at www.ato.gov.au.

Step 3 – Translation of the deductible amount

67. The deductible amount for the income year must then be translated. It will generally be translated at the same rate as the pension or annuity income it forms part of under item 6 of the table in subsection 960-50(6) of the ITAA 1997, as explained at paragraph 58 of this Determination.

68. When pension or annuity income is received as a single annual amount during an income year, the deductible amount must be translated at the exchange rate applying when it is received.

69. When pension or annuity income is received as a series of payments through the income year, the deductible amount must be proportionally allocated to each pension or annuity payment. Under item 6 of the table in subsection 960-50(6) of the ITAA 1997 each part of the deductible amount is translated at the exchange rate applying when the payment to which it is allocated is received (or when each payment is derived, if that is earlier). The translated parts of the deductible amount would then be summed to work out the total translated deductible amount for the income year.

70. However, as an alternative, an average exchange rate for the income year may be used to translate the deductible amount provided the conditions in subclause 1.3(2) of Schedule 2 to the Regulations are satisfied. Those conditions are discussed in paragraphs 63 to 66 of this Determination.

Step 4 – Subtract the translated deductible amount from the translated pension or annuity income

71. The amount included in assessable income under section 27H of the ITAA 1936 is then determined by subtracting the result of step 3 from the result of step 2.

Practical application of steps 2 and 3

72. In many cases, a foreign pension or annuity received as a series of payments is deposited directly to a bank account denominated in Australian dollars. In these circumstances, the bank will translate each payment at an exchange rate applying at the time of deposit.

73. The daily exchange rates applied by the bank can be used to translate the pension or annuity payments under clause 1.2 of Schedule 2 to the Regulations. A pensioner or annuitant may therefore simply add up the amounts deposited to the bank account in applying step 2 above.

74. To reduce the compliance costs involved in applying step 3 for pensioners or annuitants where this occurs, the Commissioner will accept as a matter of administrative practice the translation of the deductible amount using an average exchange rate for the year. This approach will be acceptable whether or not the pensioner or annuitant knows the exchange rates used by the bank to translate the pension or annuity payments.

75. However, the Commissioner will only accept a translation of the deductible amount using an average exchange rate if the pensioner or annuitant meets the relevant conditions under subclause 1.3(2) of Schedule 2 to the Regulations (see paragraph 63 of this Determination).

76. The Commissioner also considers that it is not open for a pensioner or annuitant to calculate the amount to be included in assessable income using a combination of exchange rates where it is clear that the use of that particular combination has resulted in a reduction of the amount assessed. In the absence of any changed circumstances, if the pensioner or annuitant alternates from year to year between using the average exchange rate for the income year and the spot or daily rates applying to the pension or annuity payments to translate the deductible amount, this may indicate that exchange rates are being chosen for the purpose of reducing the pensioner or annuitant's taxable income.

Appendix 2 – Alternative views

This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the binding public ruling.

Alternative views

77. The Commissioner has considered whether pension or annuity income included in assessable income by paragraph 27H(1)(a) of the ITAA 1936 is statutory income. If that is so, the translation of the foreign currency amount would be made under item 7 of the table in subsection 960-50(6) of the ITAA 1997.

78. The Commissioner considers that it is clear from the authorities cited at paragraph 48 and 49 of this Determination that pension or annuity income is ordinary income as a matter of general principle.

79. Subsection 6-10(2) of the ITAA 1997 states that an amount is statutory income *only if it is not ordinary income* but is included in assessable income by a provision of the ITAA 1936 or ITAA 1997. The note to that subsection also acknowledges that the list of provisions about assessable income in section 10-5 of the ITAA 1997 includes provisions which contain rules about ordinary income but that those rules do not change the character of the income. Therefore, the inclusion of section 27H of the ITAA 1936 in the list of assessable income provisions in section 10-5 of the ITAA 1997 cannot be used to argue that the amount is statutory income.

Applying item 11A in subregulation 960-50.01(1) of the Regulations to translation of the deductible amount

80. The Commissioner has also considered whether the deductible amount should be translated under item 11A of the table in subregulation 960-50.01(1) of the Regulations. Item 11A applies to an amount (other than an amount of a receipt or a payment) to which none of the items of the table in subsection 960-50(6) of the ITAA 1997 applies.

81. For item 11A to apply, it is necessary to argue that the deductible amount is an amount which is not a receipt or payment. For the reasons discussed at paragraphs 78 and 79 of this Determination, the Commissioner considers the deductible amount, being simply a component of the pension or annuity income, retains its character as an amount of ordinary income. Therefore, item 6 of the table in subsection 960-50(6) of the ITAA 1997 applies to the deductible amount.

Applying subsection 960-50(4) to translation of the deductible amount

82. It is argued that the deductible amount should be translated through a further application of subsection 960-50(4) of the ITAA 1997. This view is based on subsection 27H(2) of the ITAA 1936 setting out a formula to work out the deductible amount, and is therefore a calculation for the purposes of subsection 960-50(4) of the ITAA 1997. That is, instead of working out the deductible amount in foreign currency at step 1 and translating it at step 3 of the four-step process outlined above, it is necessary to translate the foreign currency amounts within the subsection 27H(2) of the ITAA 1936 formula into Australian currency before determining the translated deductible amount.

83. Under this view, the undeducted purchase price component of the subsection 27H(2) formula would most likely be translated under item 11 of the table in subsection 960-50(6) of the ITAA 1997, which applies to an amount of a receipt or a payment, where none of the other items in the table in that subsection apply. The undeducted purchase price represents one or more payments or contributions made by the pensioner or annuitant to acquire the pension or annuity.

84. In the context of the deductible amount formula in subsection 27H(2) of the ITAA 1936, the residual capital value represents a future receipt. The time of that receipt may be unknown and, in any case, it is impossible to predict what the exchange rate will be at the time of the receipt. Therefore, it is considered that item 11A in subregulation 960-50.01(1) of the Regulations, which covers an amount (other than an amount of a receipt or a payment) to which none of the items of the table in subsection 960-50(6) of the ITAA 1997 applies, would apply to translate the residual capital value under the view set out in paragraph 82 of this Determination.

85. This view is not accepted by the Commissioner as it would require two parts of an amount of ordinary income to be translated at different rates. When section 960-50 of the ITAA 1997 is read as a whole, it is clearly contemplated that amounts of ordinary income would be translated at a single rate, even if the amount consists of assessable and non-assessable parts.[15] The reference to 'other *amounts*' in subsection 960-50(4) must be read accordingly.

86. The Commissioner also notes that this view may make the currency translation of foreign pension or annuity payments cumbersome and difficult for pensioners or annuitants. In particular, recipients of foreign pensions would be required to translate contributions to funds made regularly over many years at the exchange rate applying at the time those contributions were made. This is very complex and quite impractical. Some or all of these contributions may have been made by other entities, such as a former employer of the pensioner, and the pensioner is unlikely to still hold records of these contributions. Significant compliance costs would also be involved with identifying the relevant exchange rates for the translation of the contributions.

[15] In addition to item 6 of the table in subsection 960-50(6) of the ITAA 1997, see also subsection 960-50(2).

References

Previous draft:

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Subject references:

- annuities & superannuation pensions
- deductible amount
- foreign currency translation
- superannuation, retirement & employment termination
- undeducted purchase price

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