TR 2003/12 - Income tax: Application of Section 27CAA and the Foreign Investment Fund measures to the transfer of benefits in a non-resident employer sponsored superannuation fund to an individual pension transfer policy maintained overseas by an Australian resident

Taxation Ruling
Income tax: Application of Section 27CAA and the Foreign Investment Fund measures to the transfer of benefits in a non-resident employer sponsored superannuation fund to an individual pension transfer policy maintained overseas by an Australian resident

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Preamble

The number, subject heading, ***What this Ruling is about*** *(including* ***Class of person/arrangement*** *section),* ***Date of effect****, and* ***Ruling*** *parts of this document are a 'public ruling' for the purposes of* ***Part IVAAA of the Taxation Administration Act 1953*** *and are legally binding on the Commissioner. The remainder of the document is administratively binding on the Commissioner of Taxation. Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a 'public ruling' and how it is binding on the Commissioner.*

What this Ruling is about

Class of person/arrangement

1. This Ruling applies to an individual who has emigrated to Australia prior to reaching retirement age, and where the individual transferred benefits in his/her overseas employer sponsored superannuation scheme to an individual pension transfer policy maintained overseas.[1]

2. This Ruling specifically refers to transfers of benefits out of the United Kingdom ('UK'). However, the principles it follows are applicable to transfers from other countries in similar circumstances.

Issues discussed in the Ruling

3. The Ruling provides guidance on issues that may arise under the *Income Tax Assessment Act 1936* ('ITAA 1936') in the circumstances outlined in paragraphs 1 and 2 above, for example:

[1] This and other related issues were considered in the Senate Standing Committee report entitled 'Taxation of Transfers from Overseas Superannuation Funds' of July 2002 (Commonwealth of Australia, ISBN 0 642 71182 8).

- Where an Australian resident has transferred benefits from a UK employer sponsored superannuation scheme into an individual UK pension transfer policy prior to reaching retirement age;
- Where an Australian resident holds a UK pension transfer policy, but is not yet drawing benefits from it. In particular, the Ruling addresses whether the Australian resident will be subject to Australian income tax under the Foreign Investment Funds ('FIF') regime, on the deemed annual growth of the value of the policy;
- Where a pension is drawn from the pension transfer policy;
- Where the entitlement from the transfer policy is taken as a lump sum; and
- Where there may be a foreign tax credit available for foreign income taxes paid.

A schematic diagram of the application of these measures is at attachment 'A'.

Background

4. It is a common practice in the UK for the transfer value of a person's benefits in his/her employer sponsored superannuation scheme to be transferred to an individual pension transfer policy. Typically this happens when the person has left the employer's service some years before the scheduled retirement date. The former employee legally owns the individual policy. However, the former employee may be required by UK pensions legislation to remain subject to the restrictions on when benefits may be taken, and as to what extent the benefit can be taken as a cash sum rather than a pension, similar to those that would have applied under the employer's superannuation scheme.

5. The tax implications from an Australian tax perspective arise where an individual has taken this option and then migrated to Australia prior to retirement. If the former UK resident chooses to move his/her benefits to an individual policy, the person may be subject to section 27CAA of the ITAA 1936 and the Foreign Investment Funds ('FIF') measures contained in Part XI of the ITAA 1936. Australia's double tax agreement with the UK does not affect this result.

Date of effect

6. This Ruling applies to years of income commencing both before and after its date of issue. However, the Ruling 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 Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Ruling

7. Section 27CAA of ITAA 1936 will apply to include in the Australian resident's assessable income certain amounts transferred from an **eligible non-resident non-complying superannuation fund** (see explanation in paragraph 34) to a pension transfer policy, where the transfer is made six months or more after the taxpayer becomes a resident of Australia. The provisions stipulate that the amount, calculated under section 27CAA, is included in the taxpayer's assessable income in the year in which the transfer occurred. This would be at the date of the transfer from the employer sponsored superannuation fund to the pension transfer policy. The amount included in the assessable income of the taxpayer is the gross amount of the transfer, less contributions by the taxpayer, or an employer (or past employer) of the taxpayer, since the relevant day, and less the taxpayer's accumulated entitlement (a defined term) immediately before the 'relevant day'.

8. There are rules in section 20 of the ITAA 1936 that set out how the amount worked out under section 27CAA is to be translated into Australian dollars. When an amount is simply transferred from one foreign superannuation fund to another, paragraph 20(3)(c) applies. In these cases the conversion of the foreign income into Australian currency uses the exchange rate applicable at the end of the year of income.

9. The FIF provisions will apply to a pension transfer policy where it is identified to be an interest in a foreign investment fund. The practical effect of the FIF provisions is that the accretion in value of the amount held in the pension transfer policy will be included in the assessable income of the Australian resident on an annual basis. The FIF regime does not apply where the interest in the FIF is AUD$50,000 or less.

10. Payment from the pension transfer policy can be received as an annuity, a pension, or as a lump sum. Receipt of a pension or annuity would be included in assessable income under section 27H of ITAA 1936. In the case of such a pension or annuity a deductible amount would be available under subsection 27H(2) calculated by

reference to the 'undeducted purchase price' (see paragraph 39 below) of the annuity or pension payable from the pension transfer policy. When the pension is drawn upon, the income otherwise included under section 27H is treated as non-assessable non-exempt income to the extent that amounts have previously been included in the assessable income of the Australian resident under the FIF regime (section 23AK).

11. Where payment from the pension transfer policy is received in the form of a lump sum, or is transferred to a resident superannuation fund, an amount, calculated under section 27CAA, will be included in the taxpayer's assessable income. For currency translation purposes, when an amount is paid to a taxpayer the exchange rate applicable on the day the amount is remitted is to be used. Income is taken to be remitted at the time when it is received in Australia (subsection 20(5)). Similarly, when an amount is transferred to an Australian superannuation fund, the exchange rate on the day it is received by the Australian fund is used.

12. There will be no double taxation under section 27CAA for amounts previously included as assessable income from the first transfer to the pension transfer policy. Where the accretion in value in the pension transfer policy has been included under the FIF measures (see paragraph 9 above) the payment will also be treated as non-assessable non-exempt income to the extent allowed for under section 23AK (see example in scenario 7 below).

13. Where foreign income tax has been deducted from a payment from the pension transfer fund, the taxpayer will often be entitled to a foreign tax credit under the terms of Division 18 of ITAA 1936. However in many of Australia's double tax agreements, such as the agreement with the United Kingdom, taxation of pensions and annuities would be reserved to the country of residence as determined under the Agreement, and the issue of a credit should not arise. If another country imposed a tax on the pension received by an Australian resident, in a case where that was contrary to a double tax agreement, a foreign tax credit would not be available (see further at paragraph 68 below).

Explanation

Foreign Investment Funds

Interest in a FIF or FLP

14. All foreign companies and trusts are defined as Foreign Investment Funds under the FIF provisions, which are contained in Part XI of the ITAA 1936 (subsection 481(1)). Those provisions then look to whether an Australian resident has an interest in such a FIF.

15. An interest in a FIF means the share in the foreign company or the entitlement to the income or corpus of the foreign trust. The provisions applying to FIFs also generally apply to a taxpayer with an interest (i.e. the legal title) in a foreign life policy ('FLP'). An interest in a foreign pension transfer policy held by an Australian resident qualifies as an interest in a FIF where there is an entitlement to the income or corpus of the foreign pension transfer policy. Similarly, where the investment in the foreign pension transfer policy is by way of a FLP, such investment is also subject to the FIF measures.

16. The FIF measures will apply to a taxpayer's interest in a FIF for a notional accounting period[2] that ended in the taxpayer's year of income if:

- the taxpayer had an interest in a FIF at the end of the year of income (the year of income ending on or after 30 June 1993); and
- the taxpayer was a resident at any time in that year of income. (subsection 485(3)).

17. In contrast, the measures will apply to a taxpayer's interest in a FLP if the taxpayer had the interest <u>at any time</u> during the notional accounting period of the FLP that ends in the taxpayer's year of income and the taxpayer was a resident <u>at any time</u> in that year of income (subsection 485(4)).

Operative Provision

18. The operative provision under the FIF legislation is section 529. The operative provision provides for the foreign investment fund income (whether from a FIF or FLP) to be included in the taxpayer's assessable income for the taxpayer's year of income in which the notional accounting period of the FIF ends.

19. The operative provision also apportions the amount of foreign investment fund income that is included in the taxpayer's assessable income according to the number of days throughout the year that the taxpayer is a resident of Australia (paragraph 529(2)(b)).

Exemptions

20. Given the broad spectrum of investments that the FIF measures would otherwise apply to, the legislation provides a number of exemptions. These exemptions are contained in Divisions 2 to 15 of Part XI of ITAA 1936. Two of the exemptions that could potentially

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[2] (a) in relation to a FIF, has the meaning given by section 486; or (b) in relation to a FLP, has the meaning given by section 487.

apply to individuals covered by this ruling are briefly described below.

Small Investor Exemption

21. Section 515 exempts a taxpayer from taxation in respect of foreign investment fund income that would otherwise be taken to accrue from a FIF or a FLP if the value of the interests of the taxpayer and any associates is AUD$50,000 or less. The value of the interest is taken to be:

(a) the cost incurred by the person in acquiring the interest in the FIF or FLP, as the case may be; or

(b) the market value of the interest in the FIF or of the FLP, as the case may be, at the end of the year of income,

whichever is the greater amount (subsection 515(2)).

22. Therefore, where the value of an individual's FIF or FLP interest in a foreign pension transfer policy is AUD$50,000 or less, as worked out above, and assuming that the individual holds no other FIF or FLP interests, the individual's FIF income is not subject to tax on an accruals basis.

Exemption for Interest in an Employer Sponsored Superannuation Fund

23. This exemption is only available to a taxpayer who is a natural person and who has an interest in a FIF that is an employer sponsored superannuation fund. To satisfy the conditions the fund must be maintained by the employer, or an associate of the employer, for the benefit of its employees. The taxpayer must be either a former or current employee (section 519).

24. Where an individual transfers funds out of an employer-sponsored superannuation fund to another institution which provides a pension transfer policy, such a policy is not taken to be an employer-sponsored superannuation fund where the fund or policy is not maintained by the employer, or an associate of the employer. Typically, a pension transfer policy is one provided for by an institution that is not connected to a specific employer or an associate of an employer. In these circumstances, it should be noted that the exemption does not apply even though the funds may have been transferred from an employer-sponsored superannuation fund that would otherwise have met the requirements for FIF exemption.

Method of Taxation

25. Once it has been determined that a taxpayer has an interest in a FIF or a FLP that is subject to the FIF measures, and there are no exemptions that apply to exclude that interest, then the amount of FIF income to be included in the taxpayer's assessable income must be determined. There are three methods of taxation for FIFs and two methods for FLPs.

26. The three methods available for determining FIF income from an interest in a FIF are:

- the market value method (section 537);
- the deemed rate of return method (section 543); and
- the calculation method (section 558).

Section 535 of ITAA 1936 provides certain rules as to which method should be adopted in a particular case.

27. The methods available for determining FIF income for a taxpayer with an interest in a FLP are:

- the deemed rate of return method (section 584); and
- the cash surrender value method (section 595).

Section 536 of ITAA 1936 provides certain rules as to which method should be adopted in a particular case.

Section 23AK - Amounts Paid Out of Attributed Foreign Investment Fund Income not Assessable

28. Section 23AK of ITAA 1936 treats certain amounts as non-assessable non-exempt income where the amounts were previously assessed to the taxpayer under the attribution rules contained in the FIF measures. For instance, the payment of an amount that would be included in assessable income under section 27CAA or section 27H will be treated as non-assessable non-exempt income by virtue of subsection 23AK(1)(i) to the extent of the debit.[3]

[3] Section 23AK was amended by Tax Laws Amendment Act (No 4) 2003. Essentially it substituted all references to exempt income with references to non-assessable non-exempt income. The effect of the changes is to treat amounts that fall within section 23AK as non-assessable non-exempt income for all purposes of the Act (unless otherwise stated) rather than as exempt income. The changes have effect for the 2004 income year onwards.

Attribution Account Payments

29. A feature of the FIF regime is the operation of FIF 'attribution accounts'. Debits and credits to a FIF attribution account arise in accordance with section 605 and section 606.

30. A FIF attribution debit would arise when a FIF attribution account entity ('eligible entity') makes a FIF attribution account payment. It should be noted that a FIF attribution account debit is triggered by a FIF attribution account payment, but a debit to the account can only occur to the extent of a surplus of credits over debits in the attribution account.

31. Section 603 sets out the instances in which a FIF attribution account payment occurs. Payment of an annuity or a lump sum that is assessable under section 27CAA is a FIF attribution account payment (paragraph 603(1)(h)).

32. An issue has arisen about the operation of sections 27CAA and 23AK in the case of transfers from one fund to another. The issue is whether fund-to-fund transfers, while being paid 'in relation to a taxpayer' as provided for in the wording of section 27CAA, can be regarded as paid 'to a taxpayer' in the terms of section 23AK. If that was not considered to be the case, it would be because the taxpayer is not strictly the recipient of the payment even though he or she is the beneficiary of it. On such an approach, section 23AK would not have any application.

33. The ATO considers that payment to a resident fund, for the benefit of the particular taxpayer, can reasonably be regarded, taken in its legislative context, as meeting the criteria triggering the operation of section 23AK.

Pensions and Annuities

34. Under the provisions of section 27H, pensions or certain annuities paid from an **'eligible non-resident non-complying superannuation fund' ('ENRNCSF')** are included in a taxpayer's assessable income. An ENRNCSF is a non-resident superannuation fund that has not received a notice from the Australian Prudential Regulation Authority or the Commissioner of Taxation (as the case may be) that it satisfies the requirements of the *Superannuation Industry (Supervision) Act 1993*.[4]

35. Under section 27H the whole of any superannuation pension or relevant annuity paid from an ENRNCSF which is included in a taxpayer's assessable income is reduced by the 'deductible amount'.

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[4] By virtue of section 42 of the Superannuation Industry (Supervision) Act 1993, a non-resident fund cannot be a complying superannuation fund.

The deductible amount is calculated in accordance with the formula in subsection 27H(2).

36. ITAA 1936 also provides for a tax offset on pensions and annuities paid from resident superannuation funds. The offsets are designed to compensate the taxpayer for the tax paid by the superannuation fund, on income and contributions. No offset is available where the pension or annuity is paid from an ENRNCSF, by virtue of subsection 159SM(2).

37. The FIF rules will apply in cases where the taxpayer has an interest in a superannuation fund, which is not an employer-sponsored superannuation fund. Under section 529 of ITAA 1936, FIF income must be included in a taxpayer's assessable income. Under section 23AK, amounts paid out of previously attributed FIF income are treated as non-assessable non-exempt income. Attributed FIF income includes any payments assessable under Subdivision AA of Division 2 of Part III (the Eligible Termination Payment (ETP) Subdivision), i.e. certain foreign pensions, annuities and lumps sums. In these cases, the amount, which is assessed under the ETP Subdivision, will be reduced by the amount already attributed and taxed under the FIF rules.

38. Provided that a taxpayer has included the FIF income that has accrued from 1 January 1993 (the date of commencement of the FIF legislation) in assessable income and also maintained an attribution account, then part or all of the pension income received will not be assessable under section 23AK (see explanation of 'Attribution Accounts' at paragraphs 29 to 31 above).

Undeducted Purchase Price

39. Broadly, an Undeducted Purchase Price ('UPP') comprises non-employer contributions made to purchase a pension which were not allowable deductions as defined in section 6 of the ITAA 1936 and which, for contributions before 1 July 1983, did not give rise to a rebate of income tax. The UPP forms the basis of the 'deductible amount' (calculated under subsection 27H(2) of the ITAA 1936) which is excluded from the assessable part of the recipient's gross pension (under subsection 27H(1) of the ITAA 1936).

Lump Sum Payments

40. There were a number of significant changes made to the provisions of the ETP Subdivision for lump sum payments made on or after 1 July 1994 from certain non-resident superannuation funds. Lump sum payments may be fully exempted from tax under section 27CD or partly assessable under section 27CAA.

41. To be fully exempted under section 27CD the payments must qualify as an **'exempt resident foreign termination payment'** ('ERFTP') or an **'exempt non-resident foreign termination payment'** ('ENRFTP').

Exempt Resident Foreign Termination Payment

42. To qualify as an ERFTP, as defined in subsection 27A(1), the payment from an ENRNCSF must satisfy **all** the following conditions in this definition:

- the payment is made **within 6 months** after the taxpayer terminated the employment or qualifying service in relation to an approved project;
- had the fund been a superannuation fund for the purposes of the ETP Subdivision, the payment would, apart from paragraphs (ka) and (ma) of the definition of 'eligible termination payment' in subsection 27A(1), have been an ETP;
- the employment must be for service in a foreign country or the qualifying service in respect of an approved project for the purposes of section 23AF;
- the payment **must not be exempt from tax** under the law of the foreign country (i.e. the payment must be taxed in the foreign country);
- the taxpayer must be a resident of Australia throughout the period of the employment or qualifying service;
- the payment must relate **solely** to that period of employment or qualifying service; and
- apart from this payment, all the taxpayer's foreign earnings from that employment or eligible foreign remuneration for qualifying service must be exempt from tax in Australia under sections 23AG or 23AF respectively.

Exempt Non-Resident Foreign Termination Payment

43. For a payment to qualify as an ENRFTP, as defined in subsection 27A(1), the payment from an ENRNCSF must satisfy all the following conditions of this definition:

- the payment is made from an ENRNCSF within 6 months after the taxpayer became a resident of Australia;

- had the fund been a superannuation fund for the purposes of the ETP Subdivision, the payment would, apart from paragraphs (ka) and (ma) of the definition of 'eligible termination payment' in subsection 27A(1), have been an ETP;
- the period to which the payment relates must not include any period other than a period in which the taxpayer was a non-resident or a period between the time the taxpayer became a resident and the time the taxpayer received the payment; and
- the amount paid must not exceed the amount that was 'properly payable' out of the fund to the taxpayer at the time the payment was made.

44. Certain important terms or words used in the definition of ENRFTP are either defined or self-explanatory. However, the meaning of amount 'properly payable' in the last requirement of this definition is not defined and needs further explanation. The meaning of amount 'properly payable' from an ENRNCSF is the amount of the taxpayer's vested benefit on the day it is actually paid out or transferred (see example in scenario 6 below).

45. Because of the varied arrangements and circumstances that may apply in respect of foreign superannuation funds, the ATO recognises that it will not always be easy to ascertain what the 'properly payable' amount will be in a particular case. Accordingly, it is suggested that the taxpayer proceed as follows:

- First, try and obtain the amount from the fund;
- If the amount cannot be obtained from the fund, it may be appropriate to engage the services of an actuary, especially where the amount is substantial and an incorrect estimate could result in more tax than is required being payable; and
- If the amount is insignificant, the cost of engaging the services of an actuary may outweigh any benefit. In such a case, the taxpayer should contact the ATO as soon as possible so that a figure, which best reflects that amount can be ascertained without undue costs.

46. If the payment is neither an 'exempt resident foreign termination payment' nor an 'exempt non-resident foreign termination payment', section 27CD does not apply.

Section 27CAA

47. A payment that does not satisfy section 27CD will not be exempted by that section. It may therefore fall for consideration under section 27CAA, to determine if it is partly assessable. Under this latter section, the assessable income of a taxpayer shall include a component of a lump sum payment from an ENRNCSF.

48. The portion of the payment to be included, if any, in the taxpayer's assessable income under section 27CAA is calculated with reference to subsection 27CAA(1). The term 'properly payable' used in this section has the same meaning as explained in paragraph 44 above. In general, the taxpayer's assessable income for the year of income in which the payment is made will include any amounts that accrue in an ENRNCSF that are attributable to the period that the taxpayer is a resident of Australia. This will usually be the investment earnings that accrue in the non-resident fund during that period.

49. In order to work out the investment earnings that accrue in an ENRNCSF during the period that a taxpayer is a resident of Australia, section 27CAA compares the amount properly payable (i.e. the member's vested benefit in the fund on the day of receipt), which in most cases is the amount actually received from the ENRNCSF, with the amount that would have been received if the payment had been made on the day before the taxpayer became a resident of Australia (i.e. the amount 'properly payable' being the member's vested benefit in the fund on the day before the 'relevant day' (defined in subsection 27CAA(2))).

50. In most cases, the difference between these two amounts is included in the taxpayer's assessable income under section 27CAA. The difference, of course, is exclusive of additional contributions, if any, made by the taxpayer or the taxpayer's employer on or after the relevant day.

51. In most instances the ENRNCSF should be able to supply both amounts so the calculation will be straightforward. However, in cases where the ENRNCSF is a defined benefits fund, an actuary may be required to determine the amounts properly payable, or the investment earnings in the ENRNCSF, during the period the taxpayer is a resident of Australia. Some of the same considerations noted in paragraph 45 above could apply.

52. The assumptions an actuary uses in determining the amounts must produce a result that is broadly consistent with the outcome that would be obtained by applying the prescribed method and that it is consistent with the intention expressed in the law.

53. The lump sum payment from the ENRNCSF (including any amount assessable under section 27CAA) is specifically excluded from the definition of 'eligible termination payment' (paragraph (ma) of the definition of ETP in subsection 27A(1)). If the payment is made to an Australian superannuation fund it is not a rollover and does not count towards the recipient's reasonable benefit limit. Furthermore, the payment will be exempt from capital gains tax (section 160ZZJ of ITAA 1936 and section 118-305 of *Income Tax Assessment Act 1997*).

Multiple periods of residency

54. A situation may arise where a non-resident taxpayer with an existing membership in an ENRNCSF becomes a resident of Australia, returns to their original country (becoming a non-resident of Australia) and later returns to Australia and becomes a resident again before receiving a payment from the ENRNCSF.

55. In such an example, the 'relevant day' is the first day during the period to which the relevant payment relates on which the taxpayer became a resident. This means that the first day of the first residency period will be the relevant day.

Currency translation of amounts assessable under section 27CAA

56. Section 20 of the ITAA 1936 applies for the purposes of determining the appropriate currency exchange rate for the conversion of foreign currency into Australian dollars.[5] The section refers to foreign income that is derived during a year of income. Subsection 6AB(1) of the ITAA 1936 states that a reference to foreign income includes a reference to an amount included in assessable income under section 27CAA of the ITAA 1936.

57. In relation to section 27CAA of the ITAA 1936, subsection 20(3) of the ITAA 1936 sets out the appropriate currency exchange rate to be used. According to paragraph 20(3)(a) when an amount is paid to a taxpayer the exchange rate applicable on the day the amount is remitted is to be used. Income is taken to be remitted at the time when it is received in Australia (subsection 20(5)). Similarly, when an amount is transferred to an Australian superannuation fund, the exchange rate on the day it is received by the Australian fund is used.

58. When an amount is transferred from one foreign superannuation fund to another (eg a UK pension transfer policy), paragraph 20(3)(c) applies. In these cases the conversion of the

[5] The New Business Tax System (Taxation of Financial Arrangements) Bill (No 1) 2003 proposes the repeal of section 20 of the ITAA 1936 and the insertion of Division 960 in the ITAA 1997.

foreign currency into Australian currency uses the exchange rate applicable at the end of the year of income.

Transfer of Benefits to a Superannuation Fund which is Resident in Australia

59. Section 27CAA and subsection 274(10) may apply where benefits are transferred to a superannuation fund resident in Australia.

60. Where a lump sum amount or benefit from an ENRNCSF is transferred to a resident superannuation fund either on a trustee to trustee basis or otherwise and the lump sum amount fails to qualify either as an ERFTP or ENRFTP (usually because the date of transfer is more than 6 months after the date the taxpayer became a resident of Australia), the transfer benefit falls for consideration under section 27CAA.

61. Any amounts that have accrued in an ENRNCSF from the date the taxpayer became a resident of Australia to the date of transfer of the benefits from the ENRNCSF to a resident superannuation fund must be included in the taxpayer's assessable income. **It should be noted that section 27CAA applies even though the taxpayer may not have physically received the transferred benefit.**

62. The vested benefits transferred (including any amounts assessed under section 27CAA) will not be ETPs (being specifically excluded under paragraph (ma) of the definition of 'eligible termination payment' in subsection 27A(1)), but will be undeducted contributions in the receiving resident superannuation fund. Undeducted contributions are not included as assessable income of the resident superannuation fund.

63. Because the benefits transferred are not ETPs, the period of fund membership in the ENRNCSF will not form part of the eligible service period of any future payment from the resident superannuation fund. Accordingly, when an amount is ultimately paid by the resident superannuation fund, the amount will be an ETP and split into the various components (including the undeducted contribution component) **based on the period of membership in the resident superannuation fund only.**

64. If the benefits transferred are greater than the amounts properly payable (the vested benefits), that is, the benefits exceed the amount the taxpayer would normally be entitled to receive on the date of transfer, the excess will be included in the assessable income of the resident superannuation fund as a taxable contribution under paragraph 274(10)(c).

65. The FIF measures will not apply if no FIF income accrued during the year of income because the interest in the FIFs was

disposed of before the end of the year of income. However, provided the FIF income has been disclosed as income in previous years, any attribution account credit as at 1 July 1995 or subsequently can be applied in reducing the amount otherwise assessable under section 27CAA (because of the operation of section 23AK).

Double Tax Agreements

66. In dealing with cross border payments from superannuation policies, it is necessary to consider the relevant Double Tax Agreement ('DTA'), if any, as it will allocate the taxing rights over those classes of income which fall within the DTA. In general, Australia's DTAs do not limit Australia's taxing rights over such payments to Australian residents. However, given that Australia's DTAs vary, the terms of the relevant DTA must be considered in each individual case.

67. In the case of the DTA between Australia and the UK, Article 14 deals with pensions and annuities and provides that any pension or annuity derived from UK sources by an individual who is a resident of Australia shall be exempt from tax in the UK. A lump sum payment from a UK pension transfer policy is not a periodic payment and therefore is not within the scope of Article 14. However, other provisions of the UK double tax agreement do not affect Australia's taxation of such lump sum payments to Australian residents.

Foreign Tax Credits

68. Income derived by Australian resident taxpayers from most sources in and out of Australia is assessable. However, a credit will often be allowed under the terms of Division 18 of the ITAA 1936 for foreign tax paid on the foreign income, up to the amount of Australian tax payable in respect of that income.

69. Such a credit would not be allowed in cases where, under the relevant Double Tax Agreement between Australia (the country of the person's residence) and the country from where the pension is paid, the pension was exempt in that latter country. The Australia-UK Double Tax Agreement has such a provision.

70. If the other country (for example the UK) imposed tax in a case where that was contrary to the double tax agreement, it would result in double taxation to the taxpayer. The taxpayer can present a case to the ATO to resolve the case by mutual agreement with the competent authority of the other State.

71. Foreign income is defined as income derived from sources in a foreign country (section 6AB ITAA 1936). The definition also

includes (amongst other amounts otherwise brought into assessable income):

- Lump sum payments from eligible non-resident non-complying superannuation funds (section 27CAA ITAA 1936); and
- FIF income (section 529 ITAA 1936).

72. An example of the application of the Foreign Tax Credit measures is provided in Scenario 5 below.

Examples

Scenario 1

73. John, a UK resident has accumulated superannuation benefits in a UK employer-sponsored superannuation scheme. John leaves his employment, migrates from the UK to Australia and becomes a resident of Australia. John leaves all of his superannuation benefits in the UK employer-sponsored superannuation scheme.

74. In this scenario, the relevant provisions of the Australian income tax legislation to be considered are the FIF provisions contained in Part XI of ITAA 1936. In particular, section 519 of Part XI provides that the interests of employees and former employees in an employer-sponsored superannuation fund will be exempt from taxation under the FIF provisions. Accordingly, no liability to Australian taxation under the FIF measures with regard to John's interest in the UK employer-sponsored superannuation fund will arise to John upon his migration from the UK to Australia.

Scenario 2

75. James, a UK resident, has accumulated superannuation benefits in a UK employer-sponsored superannuation scheme. James leaves his employment and transfers his entitlement under the UK employer-sponsored superannuation scheme to another institution, which provides a UK pension transfer policy. The amount is to remain with the other institution in the pension transfer policy until James reaches retirement age, whereupon the policy is to be taken as a lump sum.

76. James migrates from the UK and becomes a resident of Australia.

77. In this scenario, as in scenario 1, the relevant provisions of the Australian income tax legislation to be considered are the FIF provisions contained in Part XI of ITAA 1936.

78. From the time James migrates from the UK and becomes a resident of Australia, he would have an interest in a FIF, being the interest in the UK pension transfer policy. The accretion in value of the interest in the FIF would be assessable to James under section 529 of Part XI.

79. The accretion in value of the interest mentioned above can be calculated by several different methods depending upon the circumstances. The accretion in value of the interest in the FIF would be included in James' assessable income on an annual basis.

Scenario 3

80. Petra, a UK resident, has accumulated superannuation benefits in a UK employer-sponsored superannuation scheme. Petra migrates from the UK and becomes a resident of Australia. Eight months after becoming an Australian resident, Petra transfers her entitlement under the UK employer-sponsored superannuation scheme to another institution which provides a UK pension transfer policy. The amount remains with the other institution until Petra reaches retirement age, whereupon the policy is converted into an annuity.

81. In this scenario, the relevant provisions of the Australian income tax legislation to be considered are section 27CAA of Subdivision AA of Division 2 of Part III of ITAA 1936 and the FIF provisions contained in Part XI of the same Act.

82. The transfer from the employer-sponsored superannuation fund to the pension transfer policy will trigger the application of section 27CAA. This provision applies to include in the assessable income of Petra the accretion in value of the amount held in the employer-sponsored superannuation fund, between the time Petra became a resident of Australia and the date of transfer to the pension transfer policy.

83. The interests in the pension transfer policy would come within the ambit of the FIF provisions. The accretion in value of the interest mentioned above for the purposes of FIF can be calculated by several different methods depending upon the circumstances. The accretion in value of the interest in the FIF would be included in Petra's assessable income on an annual basis.

84. When the amount held in the superannuation transfer fund is ultimately taken as an annuity by Petra the amount of that annuity would normally be included in her assessable income. However the annuity would not be assessable to the extent of the surplus held in the FIF attribution account.

Scenario 4

85. Paul, a UK resident, has accumulated superannuation benefits in a UK employer-sponsored superannuation scheme. Paul migrates from the UK and becomes a resident of Australia. **Within 6 months** of becoming a resident of Australia, Paul transfers his entitlement in the UK employer-sponsored superannuation scheme to another institution that provides a UK pension transfer policy. The amount is to remain in the pension transfer policy until Paul reaches retirement age, whereupon the policy is taken as a lump sum.

Holding the funds in the pension transfer policy

86. During the time in which Paul holds the funds in the transfer policy, he would have an interest in a FIF and the tax consequences would be the same as that described in Scenarios 2 and 3, that is, under the FIF measures. The provisions of section 27CAA are not applicable here because the transfer to the UK pension transfer policy was made within 6 months of Paul becoming a resident of Australia.

Paul takes the entitlement from the transfer policy as a lump sum after a period of six months from the time he became a resident

87. The relevant provisions to consider in respect to this transaction are section 27CAA and the FIF provisions. The lump sum payment would not constitute an exempt resident foreign termination payment or an exempt non-resident foreign termination payment, hence the exclusion from the operation of section 27CAA would not apply. The payment would be from an eligible non-resident non-complying superannuation fund and, had the fund have been a superannuation fund for the purposes of the ETP Subdivision, the payment would, apart from paragraph (ma) of the definition of an 'eligible termination payment' in subsection 27A(1), have been an ETP. The effect of the provision would be that the accretion in value of the holding in the transfer policy, between the time Paul joined that second fund (being after he became a resident of Australia) and the date of the payment, would be included in Paul's assessable income.

88. The FIF provisions would apply in a similar manner to that set out in Scenarios 2 and 3 during the period that Paul held the funds in the transfer policy. Section 27CAA and the application of paragraph 603(1)(h) would characterise the amount included in assessable income under section 27CAA, as a FIF attribution account payment. That FIF attribution account payment (i.e. the provision of the lump sum) would give rise to a FIF attribution account debit to the extent that there is a FIF attribution account surplus in the FIF attribution account in respect of the taxpayer. Paragraph 23AK(1)(i) would treat the FIF attribution payment (the amount included in assessable

income under section 27CAA) as non-assessable non-exempt income to the extent that the FIF attribution account payment gives rise to a FIF attribution account debit.

Scenario 5

89. The following is an example of the application of the foreign tax credit measures to a payment received from a fund.

General facts

90. George began working for Lee & Co, a foreign company, on 27 November 1991. On that day he also became a member of the Lee & Co Superannuation Fund (an eligible non-resident non-complying superannuation fund). On 19 January 1994 George ceased employment with Lee & Co. On that day, the amount he was entitled to receive from the Lee & Co Superannuation Fund was $2,500.

91. George first became a permanent resident of Australia on 20 January 1994 (the day after he ceased employment with Lee & Co).

92. On 19 July 1995, George received $3,000 (before tax) from the Lee & Co Superannuation Fund. This was an amount accrued in the fund on that day. The payment included:

- Contributions paid by George of $400; and
- Contributions paid by Lee & Co of $1,600.

All contributions were paid to the fund when George was employed by Lee & Co. George paid income tax of $300 on the amount received, to the foreign revenue authority.

93. George's average rate of Australian tax payable for the 1996 financial year is 20%.

Application of the measures

94. As George was not a resident of Australia when he worked for Lee and Co, his earnings from the company would have been exempt from tax under paragraph 23(r) of ITAA 1936.

95. The payment will not be an exempt resident foreign termination payment because George was not a resident of Australia when he worked for the company. It will not be an exempt non-resident foreign termination payment because it was paid one and a half years after George became a resident of Australia. Rather, the payment will be taxed under section 27CAA.

96. George's accumulated entitlement for the purposes of subsection 27CAA(1) is $2,500 (that is, the amount he was entitled to the day before he became a resident of Australia). His additional contributions are nil because all of the contributions were paid to the fund before he became a resident of Australia.

97. The amount that will be included in George's assessable income and taxed in Australia at marginal rates of tax is $500 (i.e. $3,000 less ($2,500 + 0)).

98. As some of the payment is included in George's assessable income under section 27CAA, a credit will also be allowed for the foreign tax he paid, assuming the requirements of Division 18 of the ITAA 1936 have been met and that there is no double tax agreement preventing taxation of the amount received by George in the other country. However, the amount of credit will be limited to the lesser of the following amounts:

$300 * ($500 / $3,000) = $50; and

$500 * 20% (the average rate of tax applicable) = $100.

99. Therefore, George will be allowed a foreign tax credit of $50. The excess credit of $250 for foreign tax paid by George on this payment can be offset only against Australian tax payable on future foreign income of a similar class.

Scenario 6

100. The following example provides an explanation of 'vested benefit' and 'properly payable'.

101. Angela works for a New Zealand company and is a member of the NZ staff superannuation fund. Angela transfers to an Australian branch of the NZ Company and arrives in Australia on 1 January 1997. Angela is a resident of Australia for taxation purposes from that date.

102. The present value of Angela's benefits in the NZ fund as at 31 December 1996 is $100,000. However, at the time only 60% of that benefit is vested. The benefits remain in the NZ fund and no further contributions are made to that fund. The Australian branch starts making contributions on behalf of Angela to its staff superannuation fund (which is an Australian resident superannuation fund). Angela does not make any personal contributions to the Australian fund.

103. On 1 June 2002, Angela's benefits in the NZ fund (which have increased to $150,000) are transferred to the Australian fund. 80% of this amount is a vested benefit.

104. The amount which will be included in Angela's assessable income for the year ending 30 June 2002 under section 27CAA is $60 000, calculated as follows:

Amount 'properly payable' on 1 June 2002	
(80% × $150,000)	$120,000
less	
Amount 'properly payable' on 31 December 1996	
(60% × $100,000)	<u>$60,000</u>
Amount assessable under section 27CAA	<u>$60,000</u>

105. The amount included in the Australian fund's assessable income for the year ending 30 June 2002 as a taxable contribution under subsection 274(10) is $30,000 (that is, the difference between the amount transferred ($150,000) and the amount 'properly payable' to Angela on 1 June 2002 ($120,000)). The amount 'properly payable' to Angela on 1 June 2002 (i.e. $120,000) will take on the character of an undeducted contribution in the Australian fund.

106. Three months later Angela resigns from the company and receives an ETP from the Australian fund. Angela is not entitled to any of the excess amount transferred from the NZ fund. However, she has $12,000 benefits accrued in the Australian fund. The total ETP paid from the Australian fund is $132,000 consisting of:

- undeducted contributions of $120,000; and
- post-June 83 component of $12,000.

107. Angela will have to include the post-June 83 component of the ETP in her assessable income for the year ending 30 June 2003.

Scenario 7

108. Mary has accumulated superannuation benefits in a UK employer-sponsored superannuation scheme. On 1 January 1997 Mary migrates from the UK and becomes a resident of Australia. As with Petra in scenario 3, in September 1997, i.e. 8 months after becoming an Australian resident, Mary transfers her entitlement in the UK employer-sponsored superannuation scheme to a pension transfer policy. The taxation implications of this transfer are the same as that applicable to Petra in scenario 3. Mary's accumulated benefit at the time she became an Australian resident was $40,000 and the gross amount of the transfer to the pension transfer policy was $50,000. Assuming that there had been no further contributions to the employer-sponsored fund by Mary, or by her present or former employer, an amount of $10,000 will be included in her assessable income under section 27CAA.

109. In October 1999, Mary transfers her entitlement in the pension transfer policy to a resident superannuation fund. Section 27CAA will also apply to this second transfer from the pension transfer policy. Mary's 'accumulated entitlement' or 'vested benefit' for the purposes of section 27CAA, is the amount properly payable to her out of this fund on the day immediately before the 'relevant day'.

110. The relevant day is the day on which Mary became a member of that second fund, as this is later than the day on which she became a resident of Australia. The amount properly payable is $50,000 being the amount of the first transfer.

111. The gross payment transferred from the pension transfer policy to the resident superannuation fund is $75,000. Assuming no further contributions were made to the pension transfer policy during the period Mary was a member of that fund, an amount of $25,000 will be included in Mary's assessable income under section 27CAA. The amount previously assessed under section 27CAA is reflected in the amount of $50,000 used in the second calculation and therefore does not get taxed again.

112. However, if the accretion in the pension transfer policy between September 1997 and October 1999 had been assessed to Mary under the FIF measures, the amount of $25,000 will be treated as non-assessable non-exempt income to the extent allowed for under section 23AK. To work out how much of the $25,000 otherwise assessable to Mary under section 27CAA would not be assessable under section 23AK, the relevant steps are as follows:

(a) Work out whether any amount has been included in Mary's assessable income during the relevant period under the FIF measures. For the purposes of this exercise, let's assume that an amount of $25,000 has been included in Mary's assessable income during the 1999 year of income under the FIF measures and that the notional accounting period of the FIF attribution account entity (i.e. the UK pension transfer policy) ends at the same time as Mary's year of income. Also assume that there were no previous attribution credits or debits for the FIF attribution account entity in relation to Mary as the attributable taxpayer.

(b) Work out how much and when to credit the FIF attribution account in relation to Mary. As Mary returns the FIF income in her 1999 year of income, an attribution credit arises at the end of the relevant notional accounting period. As the notional accounting period of the FIF ends at the same time as Mary's end of year of income, the attribution credit arises at 30 June 1999. The amount of the credit is equal to the amount included in Mary's assessable income, i.e. $25,000 (see ss 605(3)). As the credit is the only amount recorded in the relevant attribution account, there is a surplus in the attribution account of $25,000. The surplus is the excess of credits over debits in the relevant attribution account.

(c) Work out whether the application of section 27CAA in relation to the second transfer in September 1999 gives rise to an attribution account payment. An attribution account payment for FIF purposes is defined in section 603. It includes an amount that is included in assessable income under Subdivision AA of Division 2 of Part III by virtue of section 27CAA. The amount of $25,000 therefore qualifies as an attribution account payment as it is included in assessable income by virtue of Subdivision AA of Division 2 of Part III.

(d) Work out whether the amount of $25,000, being an attribution account payment, qualifies as non-assessable non-exempt income under section 23AK. For an attribution account payment of this kind, it will not be assessable to the extent of the attribution debit .

(e) Work out how much of the attribution payment of $25,000 gives rise to an attribution debit. A FIF attribution debit arises where the FIF attribution account entity- in this case the UK pension transfer fund- makes a FIF attribution account payment to the taxpayer and immediately before the payment there is a FIF attribution surplus for the eligible entity in relation to the taxpayer. In this case we know from step 2 that there is a FIF attribution surplus of $25,000 at the time of the relevant FIF attribution account payment. The amount of the attribution debit is the lesser of the FIF attribution surplus and the attribution account payment. In this case it means that the attribution debit is $25,000, being both the amount of the relevant FIF attribution surplus and the attribution account payment.

(f) Work out how much of the $25,000 will be treated as non-assessable non-exempt income under section 23AK. As the attribution debit in relation to Mary is $25,000, the whole amount of the $25,000 that is included in Mary's assessable income for the 2000 year of income by virtue of section 27CAA will qualify as non-assessable non-exempt income under section 23AK.

Detailed contents list

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Commissioner of Taxation
1 October 2003

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Previously released as TR 2003/D2

Related Rulings/Determinations:

TR 92/1; TR 97/16; TR 92/20

Legislative references:

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- ITAA 1936 Div 18
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- ITAA 1936 23(r)
- ITAA 1936 23AF
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- ITAA 1936 27A(1)
- ITAA 1936 27CAA
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- ITAA 1936 27CAA(2)
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ATO references

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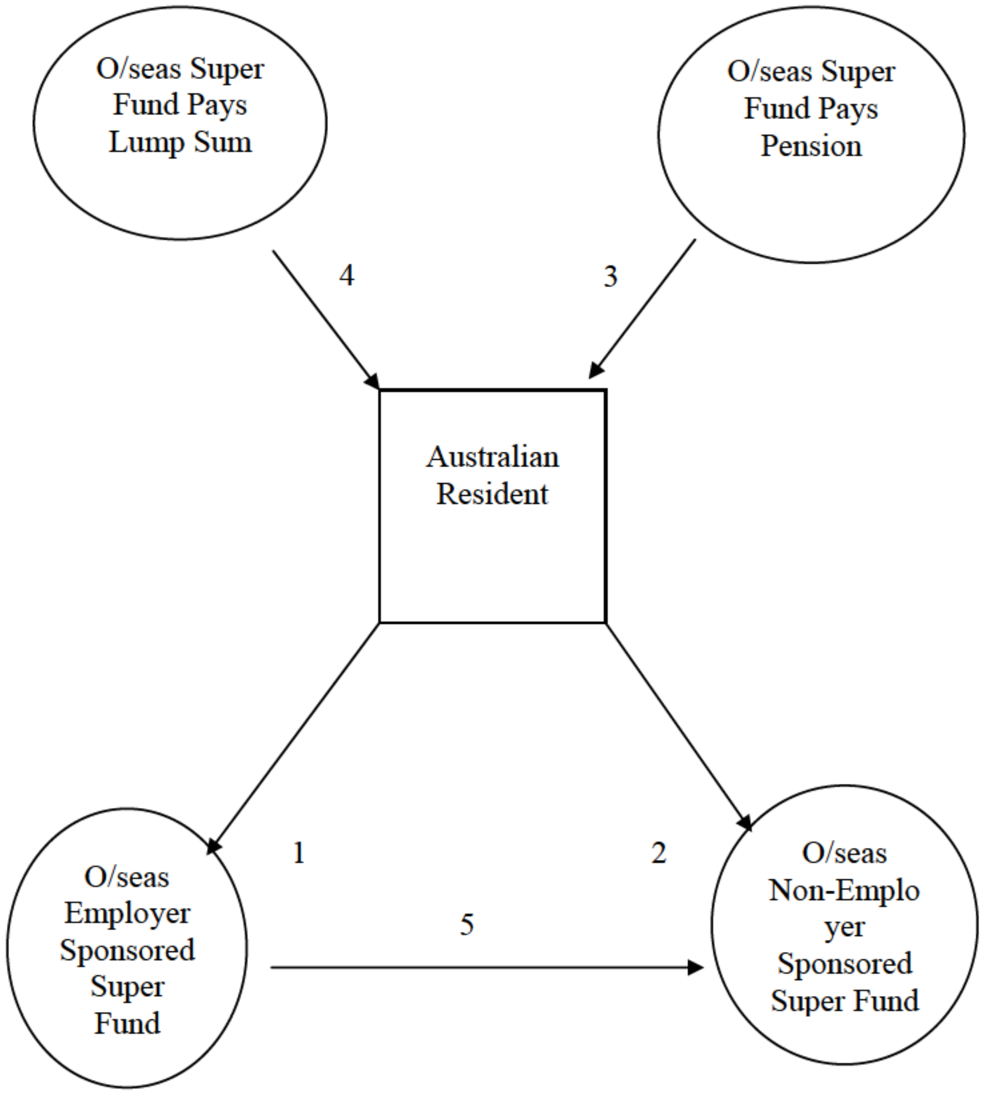
Attachment 'A'

Tranfers and Payments from Overseas Superannuation Funds



1. Australian resident's interest in the overseas Employer Sponsored Super Fund is exempt from the application of the FIF measures (under section 519 of ITAA 1936).

2. If the interest in the overseas Non-Employer Sponsored Super Fund is more than $50,000, the FIF measures apply and earnings are taxed on an accruals basis.

3. Include pension from the overseas super fund in assessable income under section 27H of ITAA 1936, with a reduction for any amounts already taxed under the FIF measures (pursuant to section 23AK).

4. Payment of the lump sum from the overseas super fund is generally exempt under section 27CD, if the lump sum is paid within 6 months of the taxpayer becoming an Australian resident. Otherwise, that part of the lump sum representing accumulations in the overseas super fund since becoming resident, is taxed at marginal rates of tax under section 27CAA. Section 23AK will exempt any amounts already assessed under the FIF measures during the accumulation phase.

5. Generally exempt under section 27CD, if the transfer from the overseas Employer Sponsored Super Fund to the overseas Non-Employer Sponsored Fund is within 6 months of the taxpayer becoming a resident. Otherwise, that part of the transfer representing accumulations in the super fund since becoming resident, is taxed at marginal rates of tax under section 27CAA.

   After the date of transfer, as the interest is now an interest in an overseas Non-Employer Sponsored Super Fund, the measures outlined in paragraph 2 above will apply. (Therefore, if the interest in the overseas Non-Employer Sponsored Super Fund is more than $50,000, the FIF measures will be triggered and any future earnings will be taxed on an accruals basis.)