

***IT 2168 - Income tax : assessment of eligible
termination payments- ELIGIBLE SERVICE PERIOD -
DISCRETIONS IN SECTIONS 27B AND 27C -
ROLL-OVER PROVISIONS - INVALIDITY PAYMENTS***

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TAXATION RULING NO. IT 2168

- INCOME TAX : ASSESSMENT OF ELIGIBLE TERMINATION PAYMENTS
- ELIGIBLE SERVICE PERIOD
 - DISCRETIONS IN SECTIONS 27B AND 27C
 - ROLL-OVER PROVISIONS
 - INVALIDITY PAYMENTS

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ELIGIBLE TERMINATION PAYMENTS
ELIGIBLE SERVICE PERIOD
INVALIDITY PAYMENTS

27A, 27B, 27C, 27D, 27G

OTHER RULING ON TOPIC: TAXATION RULING NO. IT 2157

PREAMBLE

The Income Tax Assessment Amendment Act (No. 3) 1984 inserted into Division 2 of Part III of the Income Tax Assessment Act 1936 a new Subdivision AA (sections 27A to 27J) dealing with the assessment of superannuation, termination of employment and kindred payments. Taxation Ruling No. IT 2157 of 9 May 1985 set out the manner in which section 27H is to be applied in making assessments of annuities and pensions and explained the application of section 27A to commutations of annuities and to lump sum benefits paid under the Commonwealth Superannuation Act.

2. This ruling provides further interpretations of the provisions of the Subdivision. Its more significant contents include a detailed interpretation of the definition of "eligible service period" in sub-section 27A(1) and a description of the manner in which the discretions available under sub-section 27B(2) and paragraph 27C(1) (d) are to be exercised.

3. This ruling and ruling IT 2157 do not purport to explain aspects of the legislation already explained in other documents. A general explanation of the new Subdivision can be found at pages 4-10 and 50-59 of the explanatory memorandum that accompanied the introduction of the legislation and a detailed explanation at pages 59-99. Further explanations of the general operation of the new provisions can also be found in the Non-Business Assessing Handbook, Volume 1, Part 1, Chapter 2, paragraphs 1.2.85-1.2.98.

RULING

Eligible service period

- Payments in consequence of the termination of employment

4. Where an eligible termination payment (ETP) is made in consequence of the termination of a person's employment, the eligible service period is the period, or the aggregate of the periods, of the employment to which the ETP relates. Whether an ETP "relates" to particular employment is a question of fact in each individual case. It is to be taken that the eligible service period is the person's total period of most recent continuous service with the employer making the payment (or contributing to the superannuation fund making the payment) and any related employer or employers (including any employer entity taken over by the employer or related employer or any entity in a sequence of takeovers ending with the takeover by the employer or related employer), unless there is evidence that shows that the payment was made in recognition of a different period of employment.

5. If, for example, a statutory superannuation scheme providing benefits for the staff of, say, a university were disbanded and the benefits paid out to members who continued in the same employment, failure by a former member to transfer the benefit to any replacement scheme provided would mean that any ETP paid to that person from the replacement scheme would not "relate to" the employment up to the date on which the original scheme was wound up.

6. On the other hand, the whole of an employment period would be counted where, as happens, the value of sick leave accrued during the final year of the employment is excluded from the calculation of an ETP made in respect of unused sick leave entitlements.

7. Further discussion on periods of employment to which payments relate is at paragraphs 12 to 17.

- Part-time and seasonal employment

8. Where an ETP is made in consequence of the termination of part-time employment, the eligible service period includes the number of whole days in any period of employment to which the payment relates. For example, if a person was employed for 20 hours a week over a period of 10 years, the eligible service period would be 10 years. That would apply whether the person spread the 20 hours work over 5 days each week or only over, say, 2 days.

9. Where a seasonal worker receives an ETP at the termination of a season's employment, the eligible service period is usually the period of that season's work, notwithstanding that the worker has in the past regularly been engaged on the same work and is given priority when engagements are being made at the start of the following season. For example, if a seasonal worker received a payment at the end of a season for unused sick leave entitlements that accrued during the season, the eligible service period would be the season. This general position is subject to any contrary intention

expressed in the terms of the worker's employment award or contract.

10. On the other hand, some seasonal workers are allowed to let sick leave entitlements accrue from season to season, subject to a requirement that, once the accrued entitlement passes an upper limit, payment in lieu of any excess must be taken at the end of the season. Where a lump sum payment is taken at the end of a season for such an excess, or in any other case where an unused sick leave lump sum is not clearly referable to a particular season, the eligible service period is to be taken as the aggregate of the periods of the seasons occurring after the last time at which the worker's sick leave entitlement stood at NIL. Again, this is subject to any contrary intention expressed in the terms of employment.

- Payments from superannuation funds

11. If a payment that is within paragraph (b) of the definition of an ETP (that is, a payment from a superannuation fund) accrued, in whole or in part, during a period or periods during which the taxpayer was in employment, the eligible service period is the sum of any period or periods of employment to which the ETP relates and any period of fund membership during which the ETP accrued that is not included in those employment periods. Because, in many of these cases, the relevant period or periods of employment will be greater than the period of fund membership that coincides with that employment, it will again usually be necessary to determine the period of employment to which the payment relates.

12. For example, many former State Public Service employees, who had been temporarily transferred to the Commonwealth Public Service under the Income Tax (War-time Arrangements) Act 1942, were permanently transferred to the Commonwealth Public Service in 1946. The eligible service period attaching to an ETP made under the Superannuation Act 1976 to such a person is the period of the person's service for the purposes of the Public Service Act 1922 and not the (shorter) period of contributory service for the purposes of the Superannuation Act. Under section 81S of the Public Service Act, service in the State Public Service and service while temporarily transferred to the Commonwealth Public Service forms part of the person's service in the Commonwealth (now Australian) Public Service.

13. An example of a case where non-continuous service is counted is that of a member of the N.S.W. State Superannuation Fund, entitled to a retirement pension upon completion of 10 years' employment with one or more participating employers, who partially commutes the pension. The 10 years' qualifying employment may be the sum of several shorter periods of non-continuous service at the end of any of which the member may have already received an ETP - for example, a resignation benefit. In these cases the retirement benefit would not have accrued during any earlier periods of fund membership but, to the extent these periods count as employment qualifying the

member for the retirement ETP, the ETP relates to that employment and the period of that employment therefore forms part of the eligible service period. Furthermore, the eligible service period includes all such qualifying employment (not just 10 years), including any employment while a member of another superannuation scheme if that employment is treated as qualifying employment under the N.S.W. Superannuation Act, 1916.

14. An ETP payable on withdrawal from the N.S.W. State Superannuation Fund (e.g. on resignation), however, consists of the refund of the member's contributions (with or without interest) to the fund over the member's most recent period of continuous membership and therefore does not "relate to" any previous period. If the ETP is a refund of contributions without interest, the discretion in sub-section 27B(2) would ordinarily be exercised to free the post June 1983 component from tax - on the basis that the notional 30 June 1983 payment represents the amount of the ETP less post June 1983 contributions. The pre July 1983 component of the ETP would also be freed from tax by the exercise of the paragraph 27C(1)(d) discretion - on the basis that the law applicable at 30 June 1983 would have included no part of the amount in assessable income. (Further discussion of the exercise of these two discretions is contained in paragraphs 54 to 76 of this ruling). In such a situation the payer is nevertheless required to complete a statement of termination payment showing the eligible service period and the components of the ETP calculated on the basis that the discretions will be exercised - that is, the post June 1983 component will be NIL and the pre July 1983 component will be the amount of the ETP less the amount of undeducted contributions.

- Payment following preservation of earlier termination payment

15. An ETP made from a superannuation fund may represent in part a payment received upon termination of an earlier employment (a "golden handshake") or from another superannuation fund and preserved by transfer to the fund making the ETP. Where such a transfer is the transfer of an ETP (i.e. a benefit received after 30 June 1983), Subdivision AA ensures (by way of paragraph (d) of the definition of "relevant service period") that the eligible service period includes the period that was the eligible service period in relation to the transferred benefit. This is, however, subject to the operation of sub-section 27A(10), which permits preservation of the pre July 1983 portion of the eligible service period attached to the transferred (or rolled-over) ETP only to the extent that the pre July 1983 component of that ETP is rolled over.

16. If the earlier benefit claimed by the taxpayer to have been preserved was received before 1 July 1983, and the change of employment and/or fund membership occurred, for example, within a company group or as a consequence of a company takeover, or where a self-employed person belonging to a paragraph 23(ja) fund incorporated his business and joined a section 79 fund managed by the same or an associated trustee,

the trustee of the fund making the subsequent ETP should be in a position to know whether the earlier payment has in fact been preserved and whether, as a consequence, the ETP can be said to "relate to" the earlier employment or to have accrued in part during the earlier fund membership, or both, as the case may be. The trustee can then include that period of employment and/or fund membership in the eligible service period for PAYE and roll-over purposes. If the details of the member's earlier employment and/or fund membership are not known to the trustee and the member claims that a payment to the fund made before 1 July 1983 constituted the preservation of a benefit received upon termination of employment or from another superannuation fund, the trustee may, for PAYE purposes, accept advice from the member as to the relevant periods to be included in the eligible service period and complete the statement of termination payment on that basis. A payment to a superannuation fund after 30 June 1983 should not be accepted by the trustee as constituting preservation of an earlier benefit received before 1 July 1983 unless the trustee knows that the earlier benefit has, in fact, been preserved. The foregoing is the position for PAYE purposes. The position on assessment is dealt with in the following paragraph.

17. On assessment in the cases referred to in the previous paragraph, it will be necessary to decide whether the ETP from the fund relates to the earlier employment and/or whether it accrued in part during the earlier fund membership. The broad test to be applied is whether, having regard to the circumstances surrounding the change of employment and/or fund membership, it is reasonable to conclude that the payment to the fund actually preserved the benefit received following termination of the earlier employment/membership. As a general rule, if the payment to the new fund occurred before 1 July 1983, preservation can be assumed. If, however, the change of employment/membership occurred before 1 July 1983 but the payment to the new fund purporting to preserve the earlier benefit occurred after 30 June 1983, it is for the taxpayer to displace the presumption that the payment to the new fund did not constitute preservation. Mere economic equivalence between an earlier benefit and a later payment to a fund would not assist the taxpayer if, for example :

- . there was a substantial gap between the receipt of the earlier benefit and the payment to the new fund, and the payment to the new fund was made a substantial time after the taxpayer was given the right to transfer the earlier benefit (or a part of it), or
- . the payment to the new fund was substantially less than both the earlier payment and the amount that the taxpayer was permitted to transfer into the new fund.

- Commutation or residual capital value of superannuation pension

18. Where an ETP made from a superannuation fund is in respect of the commutation or residual capital value of a

superannuation pension, the eligible service period is the sum of what would have been the eligible service period of an ETP taken in lieu of the pension at the time the pension first became payable and the period during which the pension was payable. For example:

- . if the payment is made from an employer-sponsored fund, the eligible service period normally commences on the date the member's employment commenced and ends on the date the ETP is made;
- . if the payment is made from a non-employer-sponsored fund, the eligible service period normally commences on the date the member joined the fund and ends on the date the ETP is made;
- . if the superannuation pension being terminated had previously been payable to another person (for example, a deceased spouse), the eligible service period normally commences on the date that other person commenced the relevant employment (employer-sponsored funds) or joined the fund (non-employer-sponsored funds) and ends on the date the ETP is made; and
- . if the superannuation pension being terminated was attributable in whole or in part to an earlier ETP that was rolled over into the superannuation fund, or to a pre July 1983 benefit preserved by transfer to the fund from which the pension was paid, the eligible service period includes any period that, according to the principles set out in paragraphs 11 to 17 above for the calculation of eligible service period in the case of a paragraph (b) ETP, would have been included in the eligible service period of a notional ETP made on the date the pension commenced.

The eligible service period in relation to subsequent commutations of a pension is not reduced following a partial commutation of the pension.

End of eligible service period

19. The eligible service period in relation to an ETP ends at the following time :

| ETP paragraph | End of eligible service period |
|---------------|---|
| (a) | Date employment ends. |
| (b) | Later of date employment ends and date superannuation fund membership ends. |
| (c) - (j) | Date of payment of ETP. |

20. In the case of a paragraph (b) ETP the end of the eligible service period, as described above, can be expected

usually to coincide with the date of payment. Where payment is deferred significantly beyond the termination of employment under an arrangement between the fund and the employee whereby benefits continue to accrue beyond a period that is reasonably sufficient to enable the fund manager to calculate the employee's benefit entitlement, the period up to the date of payment will be treated as a period of fund membership, notwithstanding that the rules of the fund may regard the employee as no longer being a member.

21. It is appreciated that there can be practical difficulties for payers of ETPs in forecasting for PAYE tax purposes the date on which the eligible service period will end in circumstances where, because the fund's rules provide that membership continues until the date of payment, the period ends on that date. Accordingly, for PAYE purposes, the eligible service period in such cases may be taken as being the period that ends on a date that is a reasonable estimate of the date on which the payment will be made.

Preservation of pre July 1983 eligible service period

22. As explained, sub-section 27A(10) allows preservation of the pre July 1983 portion of the eligible service period attached to an ETP that is partly rolled over only to the extent that the pre July 1983 component of the ETP is rolled over. The Roll-over Payment Notification form conveys sufficient information to the roll-over institution to enable that institution to determine the correct eligible service period for an ETP subsequently paid by the institution, but only if the ETP rolled over has not also been partly rolled over to another institution. Sub-regulation 54DAQ(5), however, provides for the Commissioner to notify a taxpayer of the extent to which the pre July 1983 part of the eligible service period of the rolled-over ETP is to be preserved where the ETP has been rolled over by means of payments to more than one roll-over institution. Where that advice is brought to the attention of the roll-over institution and the advice indicates that the pre July 1983 service to be preserved is greater than the Roll-over Payment Notification form indicates, the institution must include that larger preserved period in the eligible service period for any ETP made by the institution that is attributable to the rolled-over ETP.

Eligible termination payments on retrenchment from the Australian Public Service

23. Lump sum retrenchment payments under Determination 509 of 1977, under the Commonwealth Employees (Redeployment and Retirement) (Benefits) Regulations 1981 and under the involuntary retirement provisions of the Superannuation Act 1976 are eligible termination payments. Income maintenance payments to which employees are entitled under Determination 509 during periods of formal notice of redundancy - including periods subsequent to early termination - do not qualify as eligible termination payments but are fully assessable in the same way as ordinary salary or wages.

24. Payments under Determination 509 may qualify for the bona fide redundancy payment concession. As such a payment is additional to any resignation benefits available to an employee, concessional treatment - if applicable - applies to the whole of the payment and only 5% is required to be included in assessable income. As the law now stands, the concessional treatment is only available to Commonwealth employees aged under 55 on retrenchment. This is because they have an option to retire at that age with an early retirement benefit. However, amendments of the income tax law contained in the Income Tax Assessment Amendment Bill 1985 introduced into the Parliament on 23 May 1985 propose an easing of this restriction, with effect from 1 July 1983, to enable the concessional treatment to be available where the termination of employment occurs before age 65 and before the date on which the employment would necessarily have been terminated - for Commonwealth employees, generally the person's 65th birthday.

25. By regulation 3 of the CE(RR) (Benefits) Regulations, lump sum payments under those Regulations are made to employees aged between 55 and 60. Accordingly, such payments may qualify under the proposed amendments as bona fide redundancy payments.

26. A lump sum benefit paid under section 65 of the Superannuation Act 1976 to an employee who is retrenched is treated as an eligible termination payment by reason of its being a payment in commutation of a superannuation pension (the additional early retirement pension under Division 2 of Part V of that Act) otherwise payable to the employee. The amount to be treated as an ETP is the commutation payment reduced by the "unused undeducted purchase price" applicable to the commuted pension. The unused undeducted purchase price is the sum of the member's contributions prior to 1 July 1983 to the Commonwealth Superannuation Scheme that were not allowed as tax deductions or treated as rebatable amounts for concessional rebate purposes, and all such contributions made after 30 June 1983.

27. A lump sum benefit paid under section 62 of the Superannuation Act is also an ETP. Lump sum benefits paid under section 62 would, subject to the age constraint mentioned at paragraph 24, qualify for the concessional treatment applicable to bona fide redundancy payments in appropriate cases. For example, benefits paid to an employee who is retrenched, or retired under section 19 of the CE(RR) Act for reasons mentioned in sub-paragraph 7(1)(b)(i) of that Act, would qualify. On the other hand, benefits paid on retirement under section 19 of the CE(RR) Act for a reason prescribed for the purposes of paragraph 7(1)(b), i.e., inefficiency or absence of qualifications, would not qualify under the bona fide redundancy provisions.

Eligible termination payments from superannuation funds

- Payments in kind

28. Sub-section 27A(8) provides that an ETP made by way of

the transfer of property (that is, other than in cash) is deemed to be a payment of an amount equal to the value of the property immediately before the transfer.

29. In some superannuation schemes the trustee of the scheme holds an endowment assurance policy for each member. On withdrawal from the scheme in certain circumstances a member might have the option to either receive the surrender value of the policy or have the policy assigned to the member and continued in force by the member. In the latter situation, the ETP is the greater of the surrender value of the policy and the total of the premiums paid to that time, and the PAYE provisions do not apply.

- Set-off against loans to members

30. It may happen that the trustee causes a member's superannuation assurance policy to lapse so that the proceeds may be applied against a loan made by the trustee to the member. The full amount of the proceeds received by the trustee and either set off against the loan or paid to the member is deemed to be an ETP made to the member. Tax instalment deductions must be made from the gross proceeds, notwithstanding that the trustee's scope for setting off the loan may be thereby limited.

31. If an ETP consists partly of cash and partly of a payment in kind, such as the assignment of a life assurance policy, tax instalments are to be deducted from the whole of the ETP at the prescribed rates. If the cash component of the ETP is smaller than the prescribed instalment deduction, the deduction is to be an amount equal to the cash component.

- Voluntary savings accounts

32. Some superannuation funds administer voluntary savings schemes for fund members and their families. Although the money deposited in these savings accounts technically may form part of the fund, the accounts are generally considered to be akin to bank or building society accounts and normally attract interest which is credited annually or on some other regular basis. The interest, when credited, is assessable income taxed at ordinary rates. A withdrawal from such an account is not to be treated as an ETP.

- Arrears of pension

33. A case has arisen in which lump sum payments have been offered to superannuation fund pensioners to compensate them for a past underpayment of pension. Alternatively, the arrears could be taken as additional pension over a period of up to 2 years. It was argued for the taxpayers that the lump sum payments would be eligible termination payments on the basis that they would be made in commutation of the additional pension that could be taken under the alternative arrangement. That argument is not accepted. The arrears of pension is assessable income when received, whether as a lump sum or as a series of

payments of additional pension. Accordingly, such a lump sum payment is not an ETP, the payment being within the exception described in sub-paragraph (b) (i) of the definition of ETP in sub-section 27A(1).

- Disablement claims - advance payment

34. Superannuation fund trust deeds commonly give trustees the power to make an immediate (or advance) lump sum payment to a member whose employment has been terminated in connection with a claimed disablement. Once the disablement claim is accepted, the balance of the entitlement is paid. The advance payment is usually equal to the amount that would have been payable upon resignation without disablement.

35. It has been decided that each of the payments is a separate ETP. If the "invalidity concession" requirements of section 27G are met, the concessional treatment applies to both payments.

- Payments on death

36. A payment made from a superannuation fund to the spouse or other dependants of a deceased member (whether dying in service or in retirement) is not an ETP unless the payment is in commutation of a pension or is a payment of the residual capital value of a pension. Where the trustees of the fund have an absolute discretion to decide whether the benefit paid to the spouse or other dependants is to be by way of pension/annuity or lump sum, a lump sum payment in that situation is not regarded as being an ETP.

37. Where the surviving spouse of a former member, who died while in retirement and in receipt of a pension from the fund, elects to receive, instead of a pension, the balance of the member's accumulated entitlement in the fund, the payment is an ETP. It is either a commutation of the spouse's pension entitlement or the residual capital value of the deceased's pension.

Partial withdrawal from a superannuation fund or approved deposit fund following roll-over of ETP

38. In rolling over an ETP the extent to which each component is rolled over must be specified on a Roll-over Payment Notification form. The 4 possible components of a rolled-over ETP are :

- . pre July 1983 component
- . post June 1983 component
- . concessional component
- . undeducted contributions.

Upon roll-over, the first two components lose their identity. However, the parts of the concessional component and undeducted contributions rolled-over retain their identity so that, when a partial withdrawal is made from a superannuation fund or

approved deposit fund (ADF) into which an ETP has been deposited, the depositor may specify the extent to which the ETP made on partial withdrawal represents the rolled-over parts of the concessional component and undeducted contributions, up to the amounts of those rolled-over parts. The calculation of the pre July 1983 and post June 1983 components of the partially withdrawn ETP depends upon the depositor's specifications as to the other 2 components and the application of the general formula based on the eligible service period at the date of withdrawal.

39. Notwithstanding a partial withdrawal of a depositor's entitlement from an ADF, the eligible service period that attaches to future withdrawals will include the eligible service period that attached to the original ETP (or part thereof) rolled over into the ADF.

Death benefits

40. Where a payment to which paragraph (a), (b) or (c) of the definition of eligible termination payment applies is made to the trustee of the estate of a deceased taxpayer, the amount that would be an ETP may be reduced to take account of the extent to which the dependants of the deceased may reasonably be expected to benefit from the estate (sub-section 27A(4)). If, for example, one-third of the estate was bequeathed to dependants and the balance to other beneficiaries, two-thirds of the payment in question would normally be treated as an ETP.

41. As in sections 23F and 23FB, the definition of the term "dependant" in sub-section 27A(1) is not an exhaustive one. Accordingly, a beneficiary, unless within the specific inclusions in the definition, is a "dependant" only if he or she was actually dependent upon the deceased taxpayer for maintenance or support.

42. One of the specific inclusions in the definition of dependant is "a person who is or was a spouse of the taxpayer". That includes a person from whom the taxpayer had been divorced, but not a de facto husband or wife, although a de facto husband or wife may nevertheless be a "dependant" within the ordinary meaning of that term.

43. The PAYE provisions do not apply to eligible termination payments of any kind made to the trustee of the estate of a deceased person.

44. A payment from a superannuation fund direct to the widow of a deceased member (the payment not being a commutation payment) is not an ETP. The Commissioner does not have a discretion to treat the payment as an ETP. As it is not an ETP, the payment may not be deposited in an ADF or otherwise rolled over.

Source of ETP

45. The source and residency rules generally applicable

under the income tax law apply to ETPs. In particular, a non-resident is subject to Australian tax on an ETP from a superannuation fund if it is derived from sources in Australia. The source of a superannuation fund payment is the location of the particular fund or branch of the fund against which the payment is finally charged, and not the place where the employee's services are performed. An ETP charged against a superannuation fund that is established and controlled in Australia has its source in Australia. A fund may have its location in one country notwithstanding that it makes investments in another country.

"Conditional" roll-over of ETP

46. Some roll-over institutions offer investors a "free look" period within which they may change their mind and receive a full refund of the amount of the ETP rolled-over. Usually, the ETP rolled-over will not have been reduced by a PAYE tax instalment deduction because the payer will have regarded the payment to the institution as one referred to in sub-section 27A(12). Should a taxpayer exercise the option to withdraw the sum rolled-over within the "free look" period, the withdrawal payment is to be treated as an ETP and a PAYE tax instalment deduction made. If the taxpayer withdraws from an annuity contract, the payment will be a commutation or residual capital value payment. As announced by the Treasurer on 18 February 1985, it is proposed that the law be amended to ensure that a rolled-over ETP is not to be treated as unused undeducted purchase price in relation to the commutation of an annuity after that date. The Income Tax Assessment Amendment Bill 1985, introduced into the Parliament on 23 May 1985, gives effect to that proposal.

Roll-over of ETP - refund of tax instalment deduction

47. If a tax instalment is deducted from an ETP at the time of payment, and the payee subsequently transfers all or part of the ETP to an ADF or other roll-over institution within 90 days of payment, the payee may be entitled to a refund of all or part of the tax instalment. The refund may be made, at the Commissioner's discretion, either to the payee or to the roll-over institution.

48. A refund made direct to a roll-over institution is not a separate ETP. Treatment as a separate ETP would imply that the tax instalment deduction had reduced the size of the original ETP and would be inconsistent with the roll-over provisions. Payments to roll-over institutions may qualify as roll-over payments in relation to an ETP irrespective of whether the money used to make the roll-over payment can be traced to the money received as the ETP. An ETP is deemed to be rolled over (sub-section 27A(13)) if the roll-over provisions of the law (including the election requirements) are complied with. The fact that a payment to, say, an ADF has its source in a refund of a tax instalment deduction does not prevent the payment from being a roll-over payment that qualifies the ETP to be deemed to have been rolled over to that extent.

49. A refund of a tax instalment deduction made direct to, say, an ADF might reach the ADF after the depositor had withdrawn the deposit already made. The first withdrawal would be an ETP and any subsequent withdrawal of the tax instalment refund would be a separate ETP. Both ETPs from the ADF would be attributable to the rolled-over ETP and their eligible service periods would include the part of the eligible service period of the rolled-over ETP that was preserved by the roll-over.

Roll-over payment - interest on borrowing

50. Interest paid by the recipient of an ETP on money borrowed to enable the person to make a roll-over payment to, for example, an ADF is not an allowable deduction for income tax purposes.

Approved deposit funds - "personal" funds

51. There has been some speculation that the income tax law permits "personal" ADFs. Apparently, an organisation that is an approved trustee would establish a separate trust for each person seeking to make a deposit in an ADF conducted by the organisation, and the depositor may also be given control over the manner in which the funds are invested by the trustee.

52. The law does not specifically address this issue. An ADF must, however, be established solely for approved purposes, one of which is to deal with deposited amounts in any way calculated directly or indirectly to enhance the value of, or render profitable, property of the fund. Also, the rules of an ADF must be approved rules and, inter alia, must not permit a depositor to receive any amount from the fund otherwise than in repayment of the deposit. Furthermore, to qualify for exemption from income tax under section 23FA, an ADF must, at all times during the year of income, be maintained by an approved trustee solely for approved purposes and its rules, also at all times during the year of income, must be approved rules. If, for example, the trustee of an ADF were to make deposited funds available for the use, directly or indirectly, of the depositor, it would not be accepted that the fund complied with the law, with the result that not only would the fund be subject to income tax but any payments made to the fund would not be effective as roll-over payments. A certificate of a registered auditor is, of course, required in respect of each ADF, including "personal" ADFs.

53. Any trust fund purporting to be a "personal" ADF is to be closely scrutinised for compliance with the requirements of the law. Any doubtful cases should be referred to Head Office for further examination.

Sub-section 27B(2) discretion

54. The Commissioner may substitute a greater amount for the component AB/C in the formula in sub-section 27B(1) (the "pre July 1983" component) if he considers it appropriate to do so. In exercising the discretion the Commissioner is required

to have regard (under paragraphs 27B(2)(a) and (b)) to the amount that could reasonably be expected to have been paid to the taxpayer in consequence of the termination of employment (paragraph (a)) or of superannuation fund membership (paragraph (b)) had that termination occurred on 30 June 1983.

55. Where the ETP in question is within paragraph (a) of the definition of an ETP, paragraph 27B(2)(a) applies. The notional 30 June 1983 payment to which the Commissioner is to have regard will often readily be ascertainable from the terms of the taxpayer's contract of employment. Alternatively, as a guide to what amount might reasonably be expected to have been paid on 30 June 1983, any payment made in consequence of the termination of the employment of another employee on or about that date in circumstances similar to those that would have applied if the taxpayer's employment had been terminated on that date will be taken into account.

56. The question has been raised whether the discretion may be exercised where an ETP made in consequence of the termination of employment is a payment in lieu of unused sick leave entitlements. It has been decided that it would be appropriate to substitute as the pre July 1983 component the value at 30 June 1983 of the person's unused sick leave entitlements at that date, based on the person's salary at that date. If, as happens, the sick leave entitlements covered by the ETP exclude the entitlement that arose in the person's final year of employment, the notional 30 June 1983 payment would need to be calculated excluding the entitlement that arose in the year ended 30 June 1983.

57. If the ETP is made from a superannuation fund and is within paragraph (b) of the definition, regard is to be had under paragraph 27B(2)(b) to the ETP that might reasonably be expected to have been made in consequence of the termination of the taxpayer's membership of the fund on that date. As paragraph (b) of the definition encompasses a variety of payments, it is necessary to make additional assumptions about the notional 30 June 1983 ETP. For example, if the actual ETP is a refund of contributions, with interest, on resignation, the notional ETP is the amount that would have been the refund of contributions, with interest, on resignation on 30 June 1983. If the actual ETP is a payment, upon retirement, of an amount calculated by reference to the taxpayer's salary and/or years of service, the notional ETP would be based on the taxpayer's salary and/or years of service at 30 June 1983. If the fund rules set a minimum age at which a member qualifies for a retirement payment and a retiring taxpayer had not attained that age at 30 June 1983, the appropriate notional ETP would normally be the payment to which the taxpayer would have been entitled upon resignation on 30 June 1983.

58. If the ETP is made in respect of the commutation or residual capital value of a superannuation pension and is within paragraph (d), (e) or (f) of the ETP definition, the manner in which sub-section 27B(2) applies depends upon whether the pension was being paid on 30 June 1983. If the pension was

being paid on that date, it is to be accepted that the notional 30 June 1983 ETP would have been at least as large as the actual ETP, so that the whole of the ETP may be treated as consisting of pre July 1983 component. The post June 1983 component will then be NIL. The sub-section is to be applied in this way for both full and partial commutations. Whether regard is had to paragraph (b) or (d) of sub-section 27B(2) in any particular case will depend upon whether the commutation involves termination of membership of the relevant superannuation fund. Whichever paragraph is considered, the outcome is the same. It may happen that, although the pension was being paid on 30 June 1983, the right to commute the pension did not arise until later - for example, upon the pensioner attaining a particular age or following a change in the rules of the fund. The sub-section 27B(2) discretion is still to be exercised in these cases to treat the whole of the ETP as pre July 1983 component. If the person receiving a pension that commenced before July 1983 is not the former contributor - for example, where the pension is payable to the widow of the former contributor - the discretion is nevertheless to be applied in the manner just described.

59. If the pension being commuted did not commence until after 30 June 1983, it cannot be accepted without enquiry that the notional 30 June 1983 ETP would have been at least as large as the actual ETP. The notional ETP will usually be the payment the taxpayer would have received had he or she retired on 30 June 1983, become entitled to a pension and commuted it immediately, less any amount that would have been unused undeducted purchase price (UUPP) of the pension commencing at that date. If the taxpayer would not have been entitled to a pension had retirement occurred on 30 June 1983, the notional ETP would be the payment to which the taxpayer would have been entitled upon resignation on 30 June 1983, less an amount equal to what would have been UUPP had the resignation payment been a payment in commutation of a pension. If the pension is only partially commuted, only a proportionate part of the notional "full-commutation" ETP can be taken into account under sub-section 27B(2) and the notional reduction on account of UUPP will be proportionate to the taxpayer's actual use of UUPP in ascertaining the actual ETP.

60. The discretion in sub-section 27B(2) is not to be exercised in relation to an ETP made from an ADF (paragraph (c) of the ETP definition) or to another kind of ETP also attributable by way of roll-over to an earlier ETP unless

- . the whole of the earlier ETP has been rolled over (see the next paragraph); and
- . the ETP in question is a payment of the whole of the recipient's entitlement.

The requirement in paragraphs 27B(2) (a) and (b) that an ETP "relates to" employment or fund membership is satisfied in the case of an ETP from an ADF, or one otherwise attributable to a rolled-over ETP, if the rolled-over ETP satisfied that

requirement.

61. If an ETP is rolled over in full the discretion is not to be exercised in respect of that ETP. Any details relevant to the exercise of the discretion that are supplied by the taxpayer when furnishing the tax return that provides details of the ETP should be recorded and used in exercising the discretion, if necessary, in relation to any subsequent ETP that is attributable to the rolled-over ETP.

62. As an example of the way in which the discretion would be applied, take the case of a taxpayer, with an eligible service period of 10 years, who receives an ETP of \$10,000 from a superannuation fund on 30 June 1986. The pre July 1983 component ascertained under the standard formula would be \$7,000 (i.e. 7/10 of \$10,000). Assume that the ETP the taxpayer could have expected had the ETP been paid on 30 June 1983 is \$7,200. The taxpayer rolls over the whole amount of \$10,000 by way of payment to an ADF. Assume that the taxpayer's entitlement in the ADF at 30 June 1987 is \$11,550 and that that amount is paid as an ETP on that date. The pre July 1983 component of the ADF ETP ascertained under the standard formula would be \$7,350 (i.e. 7/11 of \$11,550). As that amount exceeds the notional 30 June 1983 ETP of \$7,200, there would be no need to exercise the discretion in relation to the ADF ETP. If, on the other hand, the taxpayer's full ADF entitlement at 30 June 1987 was only \$11,000 and this was paid as an ETP, the pre July 1983 component produced by the formula would be \$7,000. It would then be appropriate to exercise the sub-section 27B(2) discretion in relation to the ADF ETP to substitute the notional ETP of \$7,200. If the taxpayer's entitlement in the ADF on 30 June 1987 was only partly withdrawn, the discretion should not be exercised in relation to that partial withdrawal or any subsequent withdrawal.

63. ETPs made in relation to the commutation of, or termination with residual capital value of, an eligible annuity (i.e. within paragraph (g), (h) or (j) of the ETP definition) are not within paragraph 27B(2) (a) or (b). It has been decided, however, that the fact that an ETP is in one of these categories is a relevant matter under paragraph 27B(2) (d). Accordingly, the discretion may be exercised in those cases in the manner described at paragraphs 58 and 59 in connection with superannuation pensions. If the annuity had been purchased by way of the roll-over in full of an ETP, the approach set out earlier for roll-overs would apply.

64. The fact that a 30 June 1983 notional amount, capable of being substituted under sub-section 27B(2), in effect becomes a minimum total pre July 1983 component for ETPs connected by way of the full roll-over of an ETP does not mean that, in cases where the exercise of the discretion is not available in relation to a rolled-over ETP, the pre July 1983 component of that rolled-over ETP is a fixed minimum for later attributable ETPs. For example, if an ETP of \$10,000 made on 31 December 1983 had an eligible service period of 10 years attached to it (6 months being after 30 June 1983), the pre July 1983 component

would be \$9,500 ($19/20 \times \$10,000$). If the whole ETP was rolled over into a superannuation fund and the full entitlement of, say, \$10,500 withdrawn from the fund on 31 December 1984, the pre July 1983 component would be \$9,068 ($19/22 \times \$10,500$). The sub-section 27B(2) discretion would not be applied to substitute the original pre July 1983 component of \$9,500 for \$9,068.

Paragraph 27C(1)(d) discretion

65. Paragraph 27C(1)(d) gives the Commissioner a discretion to include in assessable income less than 5% of the pre July 1983 component of an ETP if the law which applied at 30 June 1983 would have included less than 5% of the ETP in assessable income.

66. Cases have arisen in which the facts surrounding the making of an ETP have been materially different from the facts which would have existed on 30 June 1983 had a payment been made then. For example, a superannuation fund made an ETP in June 1984 to a fund member upon the member's resignation from employment. The fund's rules had been changed in February 1984 to permit the payment of interest on contributions so that the lump sum payment in question consisted of the refund of the member's contributions together with interest accrued from February 1984. Had the payment consisted solely of the refund of contributions, the discretion in paragraph 27C(1)(d) would clearly have been exercised to exempt the pre July 1983 component from tax.

67. It has been decided that, although the inclusion of the interest component in the payment was consequential upon a change in the fund's rules that occurred after 30 June 1983, the presence of the interest in the payment cannot be disregarded in considering whether to apply the discretion. If paragraph 26(d) had not been repealed, it would have included 5% of the payment in assessable income, on the basis that the payment included an interest component. Accordingly, in such a case the discretion is not to be applied and the pre July 1983 component remains assessable as to 5%.

68. Similarly, where an ETP is made from a paragraph 23(ja) or section 23FB (formerly section 79) fund, consideration has to be given in applying paragraph 27C(1)(d) to whether and to what extent former section 26AE would have applied to the payment had that section not been repealed. It is open to be concluded that former section 26AE would have applied even though the conditions for the application of that section may not have existed at 30 June 1983. For example, the taxpayer may not have been entitled to a tax deduction under section 82AAT in respect of contributions to the fund up to 30 June 1983 but may have become so entitled after that date and before the ETP was made. In other words if at the date of the payment section 26AE would have applied (had it not been repealed) the discretion in paragraph 27C(1)(d) is to be exercised.

69. The manner in which the discretion is to be exercised in such a case is as follows. Former sub-section 26AE(3) is to

be notionally applied to the whole of the ETP to ascertain the extent to which the payment would have been included in assessable income (that is, expressed as a percentage - 5% or less - of the payment) had section 26AE still applied at the date of the payment and that percentage, if less than 5%, is then to be applied to the part of the pre July 1983 component that is not rolled over. In ascertaining the amount which former section 26AE would have included in assessable income, contributions made between 19 August 1980 and the date of payment are to be taken into account in terms of sub-section 26AE(3).

70. If an ETP from a superannuation fund consists only of the refund of a member's contributions, without interest, the effect of exercising the sub-section 27B(2) and paragraph 27C(1)(d) discretions is that no part of the ETP is included in assessable income. The statement of termination payment should be completed on the assumption that the two discretions will be exercised (that is, showing the post June 1983 component as NIL and the pre July 1983 component as the difference between the amount of the ETP and the undeducted contributions). No PAYE instalment needs to be deducted.

71. The situation can be expected to arise where, because all or some of the pre July 1983 component of an ETP is rolled over, the question of exercising the paragraph 27C(1)(d) discretion arises again in respect of a later ETP that is attributable to the rolled-over ETP. The later ETP may be of a kind (for example, an ADF payment) to which paragraph 27C(1)(d) could not apply directly, or of a kind in respect of which the conclusion could not be reached that a lesser amount than 5% ought to be included in assessable income. In these cases the discretion is to be applied if and to the extent that it would have been applied to the original ETP had that ETP not been rolled over. For example, assume an original ETP of \$10,000 with a pre July 1983 component of \$1,000 is rolled over into an ADF. If former section 26AE had still applied, assume that only \$40 of that component (4% of \$1,000) would have been included in assessable income. Several years later the taxpayer's interest in the ADF is paid as an ETP of \$18,000 with a pre July 1983 component of \$1,200. For the purposes of paragraph 27C(1)(d), \$1,000 of the pre July 1983 component may be regarded as attributable to the pre July 1983 component of the original ETP. The amount included in assessable income under sub-section 27C(1) would be $\$40 + (5\% \text{ of } (\$1,200 - \$1,000)) = \50 . If, say, only \$500 of the pre July 1983 component was rolled-over and the other facts were the same, the amount assessable under sub-section 27C(1) in respect of the ADF ETP would be $\$20 + (5\% \text{ of } (\$1,200 - \$500)) = \55 .

72. Where an ETP is made in commutation of a superannuation pension or annuity in circumstances where paragraph 26(d) would have applied to the ETP because the payment is in consequence of retirement or the termination of employment, the discretion in paragraph 27C(1)(d) is not to be exercised. In other cases it may be accepted that a commutation payment would have been exempt from tax under the law applying at 30 June 1983 and the

discretion may be exercised to treat the pre July 1983 component as tax-free.

73. It is for the taxpayer to request that the discretion be exercised and to supply sufficient information to enable an opinion to be formed as to whether it would be appropriate to include in assessable income a lesser amount than would otherwise be included.

Paragraph 27C(1)(d) and the concessional component

74. The situation can exist where an ETP includes a concessional component and it is also appropriate for the paragraph 27C(1)(d) discretion to be exercised to include less than 5% of the pre-July 1983 component in assessable income. In some of these cases the taxpayer may be disadvantaged by having part of the ETP treated as concessional component and included in assessable income as to 5%, thereby reducing the lower-taxed pre July 1983 component (and, usually, the higher-taxed post June 1983 component). Whether the taxpayer is disadvantaged depends upon his or her marginal tax rate and the relative sizes of the components of the ETP.

75. It is considered that the law could not have intended that the concessional tax treatment provided in the event of invalidity and certain redundancies and early retirements would operate to the disadvantage of the person concerned. Consequently, it has been decided that a taxpayer may elect not to have a part of an ETP treated as concessional component. Taxpayers planning to roll over a part of their ETP and contemplating such an election would need to bear in mind that, because the pre July 1983 component would be increased by not recognising all of the concessional component, a greater amount would have to be rolled over in order to preserve the pre July 1983 part of the eligible service period attached to the ETP.

76. For example, assume that an incapacitated 26 year old person whose "last retirement date", as defined in sub-section 27A(1), would be his or her 65th birthday, received an ETP of \$40,000 from a superannuation fund after an eligible service period (all after 30 June 1983) of 1 year, so that the "invalidity payment" (concessional) component calculated under section 27G was \$39,000. Assume also that the person's undeducted contributions to the fund were \$1,500 and so exceeded the balance of the ETP (\$1,000). Unless the invalidity component could be reduced to \$38,500, the remaining \$500 of (tax-free) undeducted contributions would be ignored and replaced by \$500 of (5% assessable) invalidity payment. This person would be able to elect to have only \$38,500 of the ETP regarded as concessional component.

Invalidity payments

77. The question has been asked whether the invalidity payment concession can apply to an ETP that is made in relation to the commutation of a superannuation pension. A condition that must be met for any application of the concession is that the ETP is made

in consequence of the termination of any employment of the taxpayer. Provided that condition is met, the concession is therefore capable of applying to an ETP made in commutation of a pension. The matters to be taken into account in determining whether the condition is met are those matters that would have been relevant under former paragraph 26(d).

78. A further condition of the availability of the concession is that the termination of employment occurred by reason of the taxpayer's physical or mental incapacity to engage in that employment. While that condition does not require that there be an incapacity to engage in any employment, it does envisage that there be a perceived permanent incapacity to engage in that employment. For example, a condition such as pregnancy would not be regarded as a relevant incapacity for the purposes of section 27G.

79. For the purposes of ascertaining the value of component C in the formula in section 27G, any days in the eligible service period that are also included in the period from the date of termination to the last retirement date (component B) are to be counted only once. That will ensure that the number of days in the notional total service period of the incapacitated person equals the number of days in the period from the start of the eligible service period to the last retirement date, as defined in sub-section 27A(1).

80. On a related matter, where the terms of a person's employment specify that he or she must retire by an age that is earlier or later than the person's 65th birthday, that earlier or later date is the last retirement date. If no date is specified, the last retirement date is the person's 65th birthday.

COMMISSIONER OF TAXATION
28 June 1985