IT 243 - Commutation of pension entitlement to a lump sum

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TAXATION RULING NO. IT 243

COMMUTATION OF PENSION ENTITLEMENT TO A LUMP SUM

F.O.I. EMBARGO: May be released

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I 1101036	PENSION LUMP SUM PAYMENT McINTOSH v FC of T 79 ATC 4325; 10 ATR 13	26(d)

FACTS On 29 June 1979 the Federal Court decision in McIntosh v FC of T 79 ATC 4325, 10 ATR 13 was handed down. The Court unanimously confirmed the decision of the Supreme Court of Queensland that section 26(d) of the Income Tax Assessment Act operated to include in the taxpayer's assessable income 5% of a lump sum commuted pension entitlement. The taxpayer has not sought leave to appeal against the Federal Court's decision.

2. In the McIntosh Case the taxpayer was a member of the National Bank of Australasia Officers' Provident Fund and under the fund's rules he had one month from the date of retirement to elect to commute his pension entitlement to a lump sum. In fact he exercised that right within 3 days of retirement. Five per cent of the commuted lump sum was included in his assessable income under section 26(d) of the Act.

3. Apart from argument whether the amount received was an "allowance, gratuity or compensation" within the meaning of the section the case was decided on the meaning to be given to the phrase "in consequence of" in section 26(d). Although the reasons given in each judgment differ somewhat each judge concluded that the particular payment was received in consequence of retirement. Lockhart and Toohey J.J. both clearly rejected the taxpayer's claim that the phrase required that the payment be "caused" by retirement. Indeed Lockhart J. said that if that were the test then it was not met. They held the phrase to mean no more than "following on" or "connected with". Brennan J. understood the phrase not to require retirement to be the "dominant" cause but merely that the payment would not have been made but for retirement. All three judges referred to the High Court judgments in Reseck v FC of T (1975) 133 CLR 45.

4. In the particular circumstances of the case nothing seems to have turned on the period allowed for commutation and no comment was made on this aspect other than by Toohey J. who mentioned that the prescription of such a short period as one month might be thought to strengthen the connection between the

payment and retirement.

RULING 5. As the decision conforms with current practice in relation to commutation of pension entitlements to a lump sum, no adjustment to that practice, which is reiterated in the following paragraphs, is necessitated.

6. Where an election to commute is exercised not later than 12 months after retirement and within an election period available under a particular fund's rules, the resultant lump sum payment is treated as being subject to section 26(d) of the Assessment Act. This is so whether or not the taxpayer has received within that period a pension prior to the exercise of the election. The election, in the latter circumstances, usually operates from the date of retirement with an adjustment being made to the lump sum in respect of the pension received in the meantime.

7. Some funds permit a member to elect upon retirement to commute his pension (or part thereof) for specified periods, e.g. the Bank of N.S.W. permits commutation of pension upon retirement and again at the expiration of each seven years. In these instances the amount received for the initial commutation would be subject to section 26(d) but the amounts received as a result of subsequent commutations under this section would not attract the operation of the section. This situation should be contrasted with funds which permit commutation of pensions for short periods only, i.e. either one or two years. Amounts received in respect of such commutations should be regarded as payment of pension in advance and assessable in full.

8. Where a right of commutation is introduced into a fund, the exercise of that right by an existing pensioner, whose pension commenced prior to such amendment, does not give rise to any taxation liability, unless the pensioner was aware before retirement of the proposal to grant that right.

COMMISSIONER OF TAXATION

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