Australian Government
Australian Taxation Office

ATO Interpretative Decision

ATO ID 2012/84

Superannuation
Excess contributions tax: concessional contributions - allocation from 'pension reserve account' supporting 'complying lifetime pension'

FOI status: may be released

Issue

Where a member of a self managed superannuation fund (SMSF) commutes a 'complying lifetime pension' payable to him, will the member have concessional contributions for a financial year if the trustees of the fund:

- use the amount standing to the credit of a 'pension account' maintained in relation to the complying lifetime pension as the superannuation lump sum (resulting from the commutation of that pension) that is transferred to commence a 'market linked pension' payable to the member, and
- allocate the amount standing to the credit of a 'pension reserve account' maintained in relation to the complying lifetime pension to enable an 'account-based pension' payable to the member to be commenced?

Decision

Yes. In those circumstances the member will have concessional contributions equal to the amount allocated to the member from the 'pension reserve account'.

Facts

Details of the complying lifetime pension payable to the member

A SMSF has two members.

On 1 July 2005, one of those members commenced an indexed pension that was payable for his life and, on his death, for his wife's life. That pension satisfied the requirements of subregulation 1.06(2) of the Superannuation Industry (Supervision) Regulations 1994 (SIS Regulations). In this ATO Interpretative Decision, such a pension is called a 'complying lifetime pension'.

The complying lifetime pension was commenced using $1.3 million of the value of the relevant member's interest in the fund. A further $200,000 was retained in the fund to accumulate for the benefit of the relevant member and was not an amount supporting any pension.

No other complying lifetime pension has ever been payable to any member of the fund.

Rules of the fund

Relevant rules of the fund when the complying lifetime pension commenced included:

- the trustee is required to maintain member accounts:
  - the trustee must, for each member, keep accounts which record contributions received, income earned, amounts allocated to or from reserves, benefits paid and all other amounts added to or deducted from the member's account
  - the balance of a member's account must be positive
  - more than one account can be kept for a member
  - an account for a member can be an 'accumulation account' or a 'pension account'
- the trustee is authorised to maintain reserves:
  - the trustee may establish such reserves and add and allocate amounts to, and deduct amounts from, those reserves as considered appropriate (provided it does not result in the fund becoming non-complying)
  - the trustee is required to formulate a separate investment strategy for the prudential management of any reserve such that the trustee is able to discharge its liabilities as and when they fall due
- the trustee is authorised to provide a pension that satisfies the requirements of the SIS Regulations, including subregulation 1.06(2):
  - the trustee must consult with an actuary before commencing to pay a complying lifetime pension to determine the amount to be set aside by the trustees to fund the pension, any reserves required and the relevant terms and conditions of the pension
  - the trustee, in its sole discretion, is authorised to apply any amount standing in a member's accumulation account, pension account or a reserve for the benefit of the provision of a pension to

a member.

The trustees' resolutions in relation to the complying lifetime pension

In accepting the relevant member's application to commence the complying lifetime pension, the trustees resolved to establish:

- a pension account from which the pension was to be paid, with an amount or assets transferred from the relevant member's account balance in the fund and
- reserve accounts as required by the fund's actuary.

The relevant member was informed of those resolutions on 1 July 2005.

Subsequently on the same day, a further resolution was made by the trustees in relation to the complying lifetime pension. The trustees resolved to establish a pension reserve account in accordance with fund rules to guarantee the payment of amounts required by the terms of the complying lifetime pension. The pension reserve account is to be used to provide the trustees with reserve assets in the event the funds invested perform poorly and the actuary is of the opinion that the reserves should be credited to fund the relevant member's complying lifetime pension.

Accounting for the complying lifetime pension

The fund's actuary advised that the sum of $1.3 million could be used to provide an indexed pension equal to $59,500 in the first year, with indexation of 3% per annum for the lives of the relevant member and his wife.

At the commencement of the complying lifetime pension, the actuary made an estimate of the value of the pension (the best estimate) which the trustees recorded in an account designated as the 'pension account'. The actuary's best estimate of the value of the complying lifetime pension was $920,000.

The balance of the $1.3 million with which the pension was commenced was recorded in an account designated the 'pension reserve account'. However, the actuary indicated to the trustees that the balance of that account, being $380,000, comprised an investment adequacy amount of $210,000, a mortality amount of $60,000 and a surplus amount of $110,000.

At the end of each year, the total value of the assets in the fund is calculated and the value of each of the accounts held for a member as an accumulation account, or account-based pension account is subtracted from that total. The remainder is treated as relating to the complying lifetime pension. An amount equal to the actuary's best estimate of the value of the complying lifetime pension is recorded as the value of the complying lifetime pension account. The remaining value of the fund is recorded as the value of the pension reserve account but is also split between an investment adequacy amount, a mortality amount and a surplus amount (if any).

The complying lifetime pension paid has at all times satisfied the requirements of subregulation 1.06(2) of the SIS Regulations.

Commutation of the complying lifetime pension

On 30 June 2011, the relevant member applied to commute the complying lifetime pension by having the balance of the:

- 'complying lifetime pension account' transferred for the relevant member to commence a new pension that satisfies the requirements of subregulation 1.06(8) of the SIS Regulations (in this ATO Interpretative Decision such a pension is called a 'market linked pension') and
- 'pension reserve account' allocated to the relevant member for the relevant member to commence a pension described in paragraph 1.06(9A)(a) of the SIS Regulations that satisfies the requirements of subregulation 1.06(9A) of the SIS Regulations (in this ATO Interpretative Decision such a pension is called an 'account-based pension').

At 30 June 2011, on the advice of an actuary, the trustees of the fund had recorded the balance of the relevant member's complying lifetime pension account as $1.2 million and the pension reserve account as $450,000, comprising an investment adequacy amount of $170,000, a mortality amount of $90,000 and a surplus amount of $190,000. Together the balance of the two accounts equalled $1.65 million.

On 1 July 2011, the trustees commuted the complying lifetime pension as requested by the relevant member. The trustees treated the balance of the complying lifetime pension account ($1.2 million) as the amount of the superannuation lump sum resulting from the commutation. That amount was transferred for the relevant member to commence the market linked pension. The balance of the pension reserve account ($450,000) was allocated to the relevant member and used by them to commence an account-based pension.

Reasons for Decision

Outline of relevant excess contributions tax (ECT) provisions

Subsection 292-25(1) of the *Income Tax Assessment Act 1997* (ITAA 1997) provides that a person's concessional contributions for a financial year is the sum of each contribution covered under subsection 292-25(2) of the ITAA 1997 and each amount covered under subsection 292-25(3) of the ITAA 1997.

Subsection 292-25(3) of the ITAA 1997 includes in a person's concessional contributions for a financial year an amount in a complying superannuation plan that is allocated for the person for the year in accordance with the conditions specified in the regulations. The relevant regulation is regulation 292-25.01 of the Income Tax Assessment Regulations 1997 (ITAR 1997).

Subregulation 292-25.01(4) of the ITAR 1997 provides that an amount allocated from a reserve is treated as being allocated in a way covered by subsection 292-25(3) of the ITAA 1997 unless an exclusion in subregulation 292-25.01(4) applies.

Relevantly, paragraph 292-25.01(4)(b) of the ITAR 1997 excepts an amount that is allocated from a reserve if:

(i)

the amount is allocated from a reserve used solely for the purpose of enabling the fund to discharge all or part of its liabilities (contingent or not) as soon as they become due, in respect of superannuation income stream benefits that are payable by the fund at that time; and

(ii)

any of the following applies:

(A)

......

(B)

on the commutation of the income stream, except as a result of the death of the primary beneficiary, the amount is allocated to the recipient of the income stream, to commence another income stream, as soon as practicable;

(C)

......

Meaning of 'reserve'

There is no definition of 'reserve' in the ITAA 1997 or the ITAR 1997.

In ATO ID 2012/32, the Commissioner concluded that 'reserve' as used in regulation 292-25.01 of the ITAR 1997 has a broad meaning and includes an amount set aside from the amounts allocated to particular members to be used for a certain purpose or on the happening of a certain event.

Reserve in this case?

In the Commissioner's view, the effect of the trustees' resolutions in relation to the complying lifetime pension and the fund's accounting for that pension is that the two, apparently separate, accounts - the complying lifetime pension account and the pension reserve account - operate in effect as a single account. Further, together the two accounts comprise an amount that is available to the trustee, not the member, to satisfy the trustee's liability to pay the complying lifetime pension.

In the Commissioner's view, the complying lifetime pension account and pension reserve account together represent a reserve (for the purposes of regulation 292-25.01 of the ITAR 1997) to guarantee the complying lifetime pension payments for the term of the complying lifetime pension.

Use of the reserve

If an amount allocated from a reserve is not to be treated as a concessional contribution by reason of paragraph 292-25.01(4)(b) of the ITAR 1997, subparagraph 292-25.01(4)(b)(i) of the ITAR 1997 requires the reserve to be 'used solely for the purpose of enabling the fund to discharge all or part of its liabilities ... in respect of superannuation income stream benefits that are payable by the fund at that time'. The complying lifetime pension is a 'superannuation income stream' as defined in regulation 995-1.01 of the ITAR 1997.

In this case the fund rules and the trustees' resolution authorised the trustee to establish and operate reserves, and to apply an amount standing in a reserve for the provision of the complying lifetime pension to the relevant member. Further, the trustee's resolution in relation to the complying lifetime pension made it clear that while ever there was a complying lifetime pension payable to the relevant member or their beneficiary, the trustee was restricted to applying the reserve to that purpose only. Further still, in this case there is no evidence that either the complying lifetime pension account or pension reserve account has been used for any purpose other than to pay the complying lifetime pension.

Commutation of the income stream

If an amount allocated from a reserve is not to be treated as a concessional contribution by reason of paragraph 292-25.01(4)(b) of the ITAR 1997, one of the sub-subparagraphs of subparagraph 292-25.01(4)(b)(ii) of the ITAR 1997 must also be met.

In this case sub-subparagraph 292-25.01(4)(b)(ii)(B) of the ITAR 1997 is relevant and requires that 'on the commutation of the income stream ... the amount is allocated to the recipient of the income stream, to commence another income stream, as soon as practicable'.

Subparagraph 1.06(2)(e)(iii) of the SIS Regulations provides that a complying lifetime pension may be commuted if the superannuation lump sum resulting from the commutation is transferred directly for the purpose of purchasing another income stream of a type specified in that subparagraph. A market linked pension is one of those specified types of income stream, but an account-based pension is not.

Regulation 6.17C of the SIS Regulations provides that if a regulated superannuation fund provides a pension under the rules of subregulation 1.06(2) of the SIS Regulations, the trustee must not allow the pension to be commuted except in accordance with that subregulation. Regulation 6.17C of the SIS Regulations ensures that the only type of pension which may be commenced by applying the amount arising from the commutation of a complying lifetime pension is another complying lifetime pension or another kind of 'complying' pension. 'Complying' pensions are those that satisfy the requirements of subregulation 1.06(2), subregulation 1.06(7) or subregulation 1.06(8) of the SIS Regulations.

This requirement is also reflected in subregulation 1.06(1B) of the SIS Regulations which allows the trustees of a fund to commence a new market linked pension after 20 September 2007 only if certain conditions are met. One of those conditions is that the new market linked pension meets the requirements of both subregulation 1.06(8) and subregulation 1.06(9A) of the SIS Regulations.

There is nothing in subregulations 1.06(1B) or (2) of the SIS Regulations that allows a trustee to apply the amount arising from the commutation of a complying lifetime pension to commence a pension that meets only the requirements of subregulation 1.06(9A) of the SIS Regulations (to be an account-based pension).

Applying the paragraph 292-25.01(4)(b) exception

As it is the Commissioner's view that the complying lifetime pension account and pension reserve account together represent a reserve for the purposes of regulation 292-25.01 of the ITAR 1997, an amount allocated from either of the two accounts may satisfy sub-subparagraph 292-25.01(4)(b)(ii)(B) of the ITAR 1997.

Therefore, where:

- the entire value of the complying lifetime pension account and the pension reserve account is allocated as the lump sum on commutation of the complying lifetime pension and
- that amount is used to commence the market linked pension for the relevant member

it is the Commissioner's view that the requirements in sub-subparagraph 292-25.01(4)(b)(ii)(B) of the ITAR 1997 would be satisfied.

However, where an amount allocated either from the complying lifetime pension account or the pension reserve account is applied to commence a pension for the relevant member that meets only the requirements of subregulation 1.06(9A) of the SIS Regulations (to be an account-based pension), that amount cannot be said to be allocated 'on the commutation of' the complying lifetime pension. Use of an amount supporting the complying lifetime pension in that way is contrary to the requirements of subregulation 1.06(1B), subparagraph 1.06(2)(e)(iii) and regulation 6.17C of the SIS Regulations. Being contrary to those regulations, such an allocation would not satisfy sub-subparagraph 292-25.01(4)(b)(ii)(B) of the ITAR 1997.

Conclusion

Accordingly on 1 July 2011, as the trustees commuted the complying lifetime pension using the whole of the amount in the complying lifetime pension account ($1.2m) to commence the market linked pension, that amount was not a concessional contribution pursuant to subregulation 292-25.01(4) of the ITAR 1997.

However, the exclusion in paragraph 292-25.01(4)(b) of the ITAR 1997 does not apply to an allocation from either the complying lifetime pension account or pension reserve account to commence an account-based pension for the member for the reasons set out above.

Date of decision: 1 June 2012

Year of income: Year ended 30 June 2012

Legislative References:
Income Tax Assessment Act 1997
subsection 292-25(1)
subsection 292-25(2)
subsection 292-25(3)

Income Tax Assessment Regulations 1997
regulation 292-25.01
subregulation 292-25.01(4)
paragraph 292-25.01(4)(b)
subparagraph 292-25.01(4)(b)(i)
subparagraph 292-25.01(4)(b)(ii)
sub-subparagraph 292-25.01(4)(b)(ii)(B)
regulation 995-1.01

Superannuation Industry (Supervision) Regulations 1994
subregulation 1.06(1B)
subregulation 1.06(2)
subparagraph 1.06(2)(e)(iii)
subregulation 1.06(7)
subregulation 1.06(8)
subregulation 1.06(9A)
paragraph 1.06(9A)(a)
regulation 6.17C

Related ATO Interpretative Decisions
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