Appendix 10

Operation of superannuation taxes on end benefits – some examples

Introduction

This appendix presents four examples on the operation of superannuation taxation arrangements upon retirement end benefits. It is based upon evidence provided to the Committee by the ATO.[1]

Example A: Under age 55 and takes a lump sum of unrestricted non-preserved elements

Carlee changed employers and received a cash eligible termination payment (ETP) of $20,000 from her employer-sponsored superannuation fund.

The amount of tax withheld is calculated on the amount of the components as follows:

ETP components		**Tax withheld**
CGT exempt component	$0	$0
Non-qualifying component	$0	$0
Undeducted contributions	$0	$0
Concessional component	$0	$0
Pre-July 83 component	$4,950	$0
Post-June 83 (Untaxed element)	$0	$0
Post-June 83 (Taxed element)	$15,050	$3,236 (21.5% of $15,050)
Post-June 1994 invalidity component	$0	$0
Gross amount of this cash payment	**$20,000**	
Total tax withheld	$3,236	
Net ETP cash payment	**$16,764**	

The tax withheld rate applicable to the taxed element of the post-June 83 component of an ETP, where the recipient is under 55 years of age, is 21.5% (i.e. a rate of 20% plus Medicare levy of 1.5%). In Carlee's case, the tax withheld of $3,236 was calculated by applying 21.5% to $15,050.

If Carlee had not provided her tax file number to her superannuation fund, tax would have been withheld at a rate of 48.5% from both the pre-July 83 component and the post-June 83 component.

1 *Submission* 134, ATO, pp. 2-6.

In her income tax return for the year in question, Carlee would have to include in her assessable income the whole amount of the post-June 83 component ($15,050) and 5% of the Pre-July 83 component ($248). That is, an assessable amount of $15,298 should be declared.

Example B: Rolls-over a superannuation eligible termination payment (ETP) to purchase an allocated pension at age 55. Commutes pension at age 58

John retired on 1 July 1999 at the age of 55. He was a member of the Public Sector Superannuation (PSS) Scheme. He rolled-over his super benefit to purchase an allocated pension. He has not previously received any superannuation or employer ETPs.

His eligible service period was made up of 4,018 pre-July 1983 days and 5,844 post-June 1983 days. The ETP was broken up into a pre-July 83 component based on the ratio of pre July 1983 days to total days. Undeducted contributions and the post-June 83 component form the remaining components of the ETP.

The ETP rolled-over was made up of the following components:

ETP components	
CGT exempt component	$0
Non-qualifying component	$0
Undeducted contributions	$63,000
Concessional component	$0
Pre-July 83 component	$159,139
Post-June 83 (Untaxed element)	$110,375
Post-June 83 (Taxed element)	$58,086
Post-June 1994 invalidity component	$0
Gross amount of this cash payment	**$390,600**

The untaxed element of $110,375 represents income to the receiving roll-over fund, upon which that fund pays income tax at a rate of 15% (i.e. $16,556).

The purchase price of the allocated pension was $374,044 (assuming no superannuation fund entry fees). As an allocated pension does not meet the pension reasonable benefit limit (RBL) standards, and as John had not received any previous payments which were assessed against the RBL, John's allocated pension is assessed against the lump sum RBL. The undeducted contributions are not counted towards the RBL. The amount that was assessed against the RBL was therefore $311,044.

As this was less than the lump sum RBL of $485,692 for the year ended 30 June 2000, there was no excessive amount.

John elected to receive a payment of $26,000 in the first year. As John is single and has not nominated a reversionary beneficiary for his allocated pension, his deductible amount is worked out by dividing the undeducted purchase price

(UPP) of his pension by his life expectation factor. The relevant factor for John was 23.13 years when the pension commenced and his UPP is the amount of his undeducted contributions. The deductible amount is therefore $2,724.

The pension/annuity rebate applying to this pension is calculated by subtracting the deductible amount from the annual pension income, then multiplying that result by 15%. The pension/annuity rebate in the first year was $3,491 (i.e. 15% of [$26,000 - $2,724]).

On 1 July 2002 John elected to commute the allocated pension to a lump sum of $375,200.

His eligible service period is now made up of 4,018 pre-July 1983 days and 6,940 post-June 1983 days.

The lump sum is made up of the following components:

ETP components	
CGT exempt component	$0
Non-qualifying component	$0
Undeducted contributions	$54,828
Concessional component	$0
Pre-July 83 component	$137,576
Post-June 83 (Untaxed element)	$0
Post-June 83 (Taxed element)	$182,796
Post-June 1994 invalidity component	$0
Gross amount of this cash payment	**$375,200**

As John has reached age 55 the low rate threshold of $112,405 for the year ended 30 June 2003 applies to the post-June 83 component. This amount is effectively tax free. The remainder of the taxed element ($70,391) is taxed at a rate of 15% plus Medicare levy of 1.5%. The tax payable on this portion is therefore $11,615.

Five percent of the pre-July 83 component ($6,879) is included in John’s assessable income for the year ended 30 June 2003 and taxed at his marginal tax rate.

The undeducted contributions are tax free.

The ETP is also counted for RBL purposes, but as the original pension was not excessive, the ETP is not excessive.

Example C: Invalidity eligible termination payment (ETP) due to permanent incapacity

Derek terminated employment because of an invalidity (a permanent disability). He has been a member of Comfort Life Company since the 1970’s. Comfort Life Company is paying Derek his superannuation savings of

$100,000. Derek can choose to have all of his ETP paid in cash to him or rolled-over to another superannuation entity (i.e. it is all 'unrestricted non-preserved').

Derek's ETP Pre-Payment Statement shows his payment has a post-June 1994 invalidity component of $40,980. Derek elects to take all of his invalidity benefit as cash (as it is unrestricted non-preserved). Derek has received no other ETPs.

The statement shows the ETP also has:

- a pre-July 83 component because Derek's membership started before 1 July 1983; and
- a post-June 83 component because Derek's membership period is also after 30 June 1983.

Extract of Derek's ETP Pre-Payment Statement

ETP components	
CGT exempt component	$0
Non-qualifying component	$0
Undeducted contributions	$0
Concessional component	$0
Pre-July 83 component	$18,775
Post-June 83 (Untaxed element)	$0
Post-June 83 (Taxed element)	$40,245
Post-June 1994 invalidity component	$40,980
Gross amount of this cash payment	**$100,000**

Derek is paid the gross amount of the ETP cash payment which is $100,000. Derek's super fund does not withhold any tax from his ETP payment. The pre-July 83 component and the post-June 1994 invalidity component are not subject to having tax withheld when they are paid. As Derek has reached age 55 the low rate threshold of $112,405 (for the year ended 30 June 2003) applies to the post-June 83 taxed element. This amount is effectively tax free.

Therefore, Derek's actual ETP payment would be $100,000. If Derek had not provided his tax file number to his super fund then the tax withheld rates applicable to his ETP would be greater (i.e. tax would have been withheld at the rate of 48.5% from both his pre-July 83 component and post-June 83 component).

In his income tax return for the year in question, Derek would have to include in his assessable income the whole amount of the post-June 83 component ($40,245) and 5% of the Pre-July 83 component ($938). That is, an assessable amount of $41,183 should be declared.

Although the post-June 83 component is included as income, in Derek's case an ETP rebate will operate which will effectively make that amount tax free.

Example D: Payment of a lump sum death benefit to a dependant of the deceased

Bob dies at age 60 while still a contributing member of his super fund. The death benefit is paid to his wife, as his dependant. She receives the benefit in the form of a lump sum payment.

The payment is made up of the following components:

ETP components	
CGT exempt component	$0
Non-qualifying component	$0
Undeducted contributions	$230,000
Concessional component	$0
Pre-July 83 component	$621,636
Post-June 83 (Untaxed element)	$0
Post-June 83 (Taxed element)	$630,727
Post-June 1994 invalidity component	$0
Gross amount of this cash payment	**$1,482,363**

As it is a death benefit payment and not related to a pension that had already commenced, the lump sum is assessed against Bob's pension reasonable benefit limit (RBL). His pension RBL is $1,124,384 for the year ended 30 June 2003.

The undeducted contributions are not assessable against the RBL. This leaves $1,252,363 that is counted for RBL purposes. The excessive component of the ETP is therefore $127,979 (i.e. $1,252,363 - $1,124,384).

The excessive component is taxed at a rate of 47% plus Medicare levy of 1.5%. The tax payable is $62,070 (i.e $127,979 * 0.485).

The rest of the lump sum is not taxable, as it is a death benefit paid to a dependant and is under the pension RBL of the deceased.