

1985

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

INCOME TAX ASSESSMENT AMENDMENT BILL 1985

EXPLANATORY MEMORANDUM

(Circulated by authority of the Treasurer,
The Hon. P.J. Keating, M.P.)

GENERAL OUTLINE

This Bill will amend the Income Tax Assessment Act 1936 to modify the provisions introduced last year relating to the taxation of lump sum superannuation, termination of employment and kindred payments. The provisions of the Bill will :

- . overcome a technical deficiency in the law and ensure that no part of the eligible service period accruing before 1 July 1983 in relation to an eligible termination payment is preserved where none of the pre - 1 July 1983 component of that eligible termination payment is rolled-over into a superannuation fund or approved deposit fund, or is applied in purchasing an annuity (proposal announced on 22 January 1985);
- . prevent a rolled-over eligible termination payment that is used to purchase an annuity or a superannuation pension from being treated as unused undeducted purchase price in relation to a commutation or residual capital value of the annuity or superannuation pension (proposal in relation to annuities announced on 18 February 1985);
- . provide that the approved rules of approved deposit funds must require deposits made by a taxpayer who has since died to be paid to the estate of the deceased depositor not later than 90 days after the grant of probate or letters of administration in relation to that estate;
- . replace the existing test of premature retirement, for the purposes of the bona fide redundancy and approved early retirement scheme payment concessions, so that retirement will be premature if it occurs before the date (being no later than age 65) on which termination would have to occur by reason that the employee attained a particular age or completed a particular period of service;
- . treat annuities, and supplements to pensions and annuities, as "salary or wages" for tax instalment deduction purposes; and
- . in several respects, clarify and reinforce the intended operation of the eligible termination provisions of the income tax law.

FINANCIAL IMPACT

At the time of introduction of the new measures for taxing lump sum superannuation, termination of employment and kindred payments, it was estimated that \$70m in additional revenue would be collected in 1984-85. That remains the estimate. The revenue gain is expected to rise steadily over the years as the proportion of future lump sum payments in respect of service after the transition date (30 June 1983) rises.

The measures contained in the Bill will, on the one hand, ensure that certain eligible termination payments do not attract a greater amount of tax than was originally intended. On the other hand, they will remove avenues for avoidance of tax by use of the existing law in relation to the truncation of eligible service periods and the commutation of deferred annuities. The extent to which those areas of the law may have already been exploited will not be known until after 1984-85 income tax returns have been scrutinized. However, the ongoing promotion to the public of facilities that offer tax savings by exploiting those provisions suggests that the remedial measures contained in the Bill will prevent the future loss of significant amounts of revenue.

MAIN FEATURES

This Bill proposes a number of changes to the arrangements for taxing superannuation, termination of employment and kindred payments which were inserted into the law by the Income Tax Assessment Amendment Act (No. 3) 1984. The main features of the Bill are as follows :

Preservation of eligible service period on roll-over of an eligible termination payment (Clause 3, paragraph (k))

Under amendments proposed by the Bill, a drafting error in provisions relating to the calculation of the eligible service period of certain eligible termination payments is to be remedied. Where an eligible termination payment is attributable, by roll-over, to an earlier eligible termination payment, the principle underlying the law is that the eligible service period of the earlier payment is included in the eligible service period - but only to the extent that the pre - 1 July 1983 component of the earlier payment has been rolled-over. Under the existing law, where none of the pre - 1 July 1983 component is rolled over, the entire eligible service period of the earlier eligible termination payment is included in the eligible service period of the later payment. The proposed amendments will correct this drafting error and ensure that, where none of the pre - 1 July 1983 component of the

earlier payment is rolled-over, no part of the eligible service period relating to service or fund membership prior to 1 July 1983 is preserved.

As announced on 22 January 1985, the proposed amendments will apply from the date of first effect of the provisions relating to the taxation of eligible termination payments - that is, 1 July 1983.

Commutations and residual capital values of annuities and superannuation pensions

(Clause 3, paragraphs (e), (f), (h) and (n), and clause 6)

This Bill will give effect to the proposal, announced on 18 February 1985, to prevent rolled-over eligible termination payments that are used to purchase annuities from being treated as unused undeducted purchase price of the annuities.

Under amendments proposed by the Bill, where an annuity wholly purchased with an eligible termination payment is commuted after 18 February 1985, or the residual capital value of the annuity becomes payable after that date, the amount of the eligible termination payment in respect of the commutation or residual capital value will not be reduced by any unused undeducted purchase price. Where the annuity was purchased partly by the roll-over of an eligible termination payment and partly from other funds, the unused undeducted purchase price will be calculated by reference only to the amount of those other funds.

The Principal Act will also be amended to ensure that an appropriate part of any undeducted contributions component or concessional component of the eligible termination payment rolled-over to buy the annuity - which, under the existing law, would form part of the tax-free unused undeducted purchase price - will, when received as part of an eligible termination payment in relation to the commutation or residual capital value of such an annuity, continue to be either tax-free (in the case of undeducted contributions) or included in assessable income only to the extent of 5% (in the case of the concessional component).

A consequential amendment of section 27H of the Principal Act is to be made to make it clear that, following the partial commutation of an annuity to which the proposed amendments apply, the calculation of the annual deductible amount to be excluded from the reduced annuity on account of undeducted purchase price can reflect the extent to which undeducted purchase price has already been recouped in the form of deductible amounts, unused undeducted purchase price and components of the eligible termination payment arising from the partial commutation.

The proposed amendments will also apply to commutations of superannuation pensions and payments of the residual capital value of superannuation pensions after the date this Bill was introduced into the Parliament.

Eligible termination payments

(Clause 3, paragraphs (b),(g) and (j))

Under the law, payments made in relation to the commutation of superannuation pensions and certain annuities are taxed as eligible termination payments. However, some doubt has been expressed that amounts received as consideration for the assignment or transfer of those pensions and annuities are taxable in that way. The Bill proposes an amendment to the law that will put the matter beyond doubt. An amount received in respect of the assignment or transfer, after the date the Bill was introduced into the Parliament, of a superannuation pension or annuity - being a pension or annuity that would, if commuted, give rise to an eligible termination payment - will be treated as an amount received on commutation of the pension or annuity, and thus taxable as an eligible termination payment.

By an amendment of the income tax law by the Income Tax Assessment Amendment Act (No. 5) 1984, benefits received on or after 7 December 1983 under certain tax avoidance arrangements (colloquially called "cherry picker schemes") associated with employer sponsored employee superannuation funds are included in full in the assessable income of the recipient. A consequential amendment is proposed by this Bill to ensure that any such benefits paid after the date it was introduced into the Parliament do not qualify for the more favourable tax treatment applicable to eligible termination payments.

The Bill will also make it clear that payments made after that date on the commutation of a superannuation pension or as the residual capital value of such a pension are taxed in accordance with the specific rules that relate to such payments. Under the existing law, there may be some scope for the argument that, notwithstanding that these particular payments are each separately dealt with in the definition of eligible termination payment, they may be treated alternatively as general payments from a superannuation fund that are subject to a different taxing rule.

A further amendment will provide that, where an eligible termination payment is in the form of a transfer of property - for example, a "golden handshake" consisting of a parcel of shares - any consideration paid in respect of that transfer will be taken into account in determining

the net amount that is subject to tax. This amendment - of benefit to taxpayers - is to apply from 1 July 1983, the date from which the eligible termination payments legislation first applied.

Employer contributions

(Clause 3, paragraphs (g) and (h))

Contrary to the intended operation of the law, some doubt has been expressed as to whether non tax-deductible payments by an employer to purchase an annuity for an employee, or as contributions to a superannuation fund for an employee, may be treated in the hands of the employee as "undeducted purchase price" of the annuity or "undeducted contributions" of the superannuation benefits. The law is to be amended to make it clear that payments of that kind made by an employer after the date this Bill was introduced into the Parliament cannot be so treated.

Bona fide redundancy payments and approved early retirement scheme payments

(Clauses 4 and 5)

Under the existing law, all or part of an eligible termination payment received on premature termination of the employment of a taxpayer under an approved early retirement scheme or a bona fide redundancy scheme may continue to be taxed under the rules that applied prior to 1 July 1983. The part of such a payment taxed in that way is the excess of the payment over the amount that would have been received if the employment of the taxpayer had been terminated at that time otherwise than by early retirement or redundancy.

The present test of premature termination of employment has regard to the date on which, by reason of reaching a particular age or completing a particular period of service, the taxpayer could voluntarily retire from employment. Accordingly, if the time has passed when an early retirement option could have been exercised, the taxpayer is excluded from eligibility for the concessional treatment.

That test will be eased by this Bill to enable the concessional treatment applicable to bona fide redundancy payments and approved early retirement scheme payments to be available where the termination of the taxpayer's employment occurs before the date, provided it is not later than the person's 65th birthday, on which employment would necessarily have been terminated by reason of the person attaining a particular age or completing a particular period of service. The proposed amendment - of benefit to taxpayers - is to apply from 1 July 1983.

Another amendment will enable the current value of retirement benefits forgone - for example, a superannuation pension on retirement - to be taken into account in determining, for the purposes of the early retirement and redundancy payment concessions, the amount that would have been received on voluntary termination of employment. This proposed amendment will apply to relevant payments made in respect of termination of employment after the date this Bill was introduced into the Parliament.

Approved deposit funds

(Clause 3, paragraphs (a) and (n))

It is a requirement of the existing law that the rules of an approved deposit fund must provide for the repayment of deposits not later than the 65th anniversary of the depositor's birth - that is, normal retirement age. The Bill proposes an amendment to ensure that that requirement does not permit amounts deposited in an approved deposit fund by a person who has since died to be left in the fund to accumulate tax-free income until the date on which the depositor would have turned 65. Such deposits will have to be paid to the estate of the deceased depositor within 90 days of the grant of probate or letters of administration in relation to that estate.

A further amendment, effective from 1 July 1983, will enable the Commissioner of Taxation to disregard the temporary failure by an approved deposit fund to meet any of the statutory establishment tests. At present, the inadvertent failure of a fund to satisfy the tests means that, technically, eligible termination payments rolled-over into the fund are not freed from tax.

Annuities

(Clause 3, paragraphs (d) and (m), and clause 8)

Where an eligible termination payment otherwise subject to tax is used to purchase an annuity for the taxpayer's benefit, or for the benefit of the taxpayer's dependants in the event of the taxpayer's death, the payment is freed from tax. Where that annuity is commuted, the amount received is intended to be treated as an eligible termination payment and subject to tax accordingly. However, under the existing law, that intention can be thwarted where an eligible termination payment and some additional moneys, even a token sum, are applied to purchase a deferred annuity that is then commuted. The amount received on commutation is not taxable because its source is an annuity that was not purchased wholly from an eligible termination payment.

That defect is to be remedied by this Bill. Where, after the date the Bill was introduced into the Parliament, an eligible termination payment is used to

purchase a deferred annuity, the payment will not be freed from tax unless the annuity is purchased wholly out of that payment.

The Bill will also remedy a technical defect in the existing law and will ensure that "undeducted purchase price" can be excluded from the assessable amount of all annuities and not just "eligible annuities". This amendment - which will benefit taxpayers - will apply from 1 July 1983.

A further amendment will require pay-as-you-earn tax instalments to be deducted from annuities and supplements to pensions and annuities paid on or after the first day of the second month after that in which the Bill becomes law.

Rebate of tax in respect of eligible termination payments
(Clause 7)

The fully taxable post-30 June 1983 component of an eligible termination payment is subject to a maximum rate of tax of 30% and, where the taxpayer is aged 55 or more, the first \$50,000 is taxed at a maximum rate of 15%. Where the tax that would otherwise be payable at normal rates exceeds the tax at these maximum rates, a rebate is allowed.

Because of a drafting technicality, the rebate that reduces the rate of tax to 15% in "over 55" cases is not available where an eligible termination payment is received by the trustee of the estate of a deceased taxpayer even though, had the deceased lived, he or she would have been entitled to it.

Eligible termination payments made on or after 1 July 1983 to the trustee of the estate of a deceased person who was 55 or more at the date of death will be made subject to a rebate of tax in appropriate cases to reduce the rate of tax to 15%.

A more detailed explanation of the provisions of the Bill is contained in the notes that follow.

Clause 1 : Short title, etc.

By sub-clause (1) of this clause the amending Act is to be cited as the Income Tax Assessment Amendment Act 1985.

Sub-clause (2) facilitates references to the Income Tax Assessment Act 1936, which is the Act being amended by this Bill. That Act is referred to in the Bill as "the Principal Act".

Clause 2 : Commencement

Under clause 2 the amending Act is to come into operation on the day on which it receives the Royal Assent. But for this clause the amending Act would, by reason of sub-section 5(1A) of the Acts Interpretation Act 1901, come into operation on the twenty-eighth day after the date of Assent.

Clause 3 : Interpretation

Clause 3 of the Bill proposes various amendments to section 27A of the Principal Act, which contains a number of definitions and interpretational provisions necessary for the operation of Subdivision AA of Division 2 of Part III of the Act.

Subdivision AA deals with the taxation of retirement and kindred payments made on or after 1 July 1983. It defines the payments affected (called eligible termination payments) and provides the rules to determine the extent to which they are to be included in assessable income. The Subdivision also provides for the taxing of annuities and superannuation pensions.

By paragraph (a) of clause 3, the definition of "approved rules" in sub-section 27A(1) of the Principal Act is to be amended. These rules are rules with which an approved deposit fund must comply to maintain its status as such a fund. An approved deposit fund is a fund into which an eligible termination payment can be rolled-over and freed from tax until it is returned to the taxpayer.

Under existing paragraph (c) of the definition of "approved rules", amounts deposited with an approved deposit fund are required to be repaid, together with accumulated earnings, no later than the 65th anniversary of the depositor's birth. There have been suggestions that, where a depositor dies before reaching age 65, the deposit may remain with the approved deposit fund accumulating tax-free earnings until the date on which the depositor would have attained 65 years of age if he or she had lived. The fundamental purpose of approved deposit funds

is to provide a means for taxpayers to hold superannuation and like benefits until retirement age or until another superannuation fund becomes available. To allow the funds of deceased depositors to accumulate in the manner suggested is inconsistent with this concept. Existing paragraph (c) is, therefore, to be omitted and a new paragraph substituted.

New paragraph (c) of the definition of "approved rules" will restate the requirement of the existing paragraph and add the further requirement that, if a depositor has died, amounts on deposit, together with accumulated earnings, are to be paid to the legal personal representative of the deceased within 90 days after the grant of probate or letters of administration in relation to the depositor's estate.

The new rule will apply to all existing and future approved deposit funds. However, under sub-clause 9(1) of this Bill, the introduction of the new rule will not jeopardise the status of existing funds for the purposes of Subdivision AA - which status depends on the funds having satisfied certain tests on establishment. Moreover, trustees of those funds will be given a reasonable time in which to put the new rule in place so as to meet the requirements for income tax exemption in terms of section 23FA of the Principal Act. In those cases where depositors have already died or die prior to the date on which the Bill becomes law, existing funds will be expected to repay deposits within 90 days of the later of that date and the date on which probate or letters of administration are granted.

Paragraph (b) of clause 3 proposes the omission of paragraph (b) of the definition of "eligible termination payment" in sub-section 27A(1) of the Principal Act and the substitution of a new paragraph. Existing paragraph (b) defines an eligible termination payment as a payment to a taxpayer from a superannuation fund by reason of the taxpayer's membership of the fund. Benefits that are assessable under section 26AF of the Principal Act - broadly, superannuation benefits that are not paid in accordance with the relevant superannuation fund's approved terms and conditions - are specifically excluded from paragraph (b).

Consistent with that exclusion, new paragraph (b) of the definition of "eligible termination payment" will also exclude benefits that are assessable under section 26AFA of the Principal Act. That section, which was inserted in the Principal Act by the Income Tax Assessment Amendment Act (No.5) 1984, requires certain benefits received on or after 7 December 1983 under tax avoidance arrangements associated with employer sponsored employee superannuation funds to be included in full in the

recipient's assessable income. Their exclusion from paragraph (b) will ensure that any such benefits do not qualify for the more favourable tax treatment applicable to eligible termination payments.

The new paragraph (b) will also make clear the intended operation of the law by ensuring that payments in relation to superannuation pensions that qualify as eligible termination payments under paragraphs (d) or (e) of the definition may not as an alternative be treated as eligible termination payments under paragraph (b) and so be subject to a different taxing rule.

The substitution of new paragraph (b) in the definition of "eligible termination payment" is, under sub-clause 9(3), to apply to payments made after the date on which this Bill was introduced into the Parliament.

Paragraph (c) of clause 3 proposes the insertion in sub-section 27A(1) of the Principal Act of a definition of "non roll-over deductible amount". The definition is essentially a drafting device to facilitate the calculation of unused undeducted purchase price where the formula in proposed paragraph (c) of the definition of unused undeducted purchase price (to be inserted by paragraph (e) of this clause) applies. The operation of that formula is explained in the notes on paragraph (e) and on proposed new sub-section 27A(16) to be inserted by paragraph (n) of clause 3.

By paragraph (d) of clause 3, the definition of "purchase price" in sub-section 27A(1) will be amended with effect from 1 July 1983 so that it applies to all annuities. By oversight that definition does not presently apply to annuities other than "eligible annuities" - that is, annuities presently payable, purchased wholly from rolled-over eligible termination payments or payable under superannuation policies. Technically, this means that an allowance for undeducted purchase price cannot be taken into account in ascertaining the amount assessable under section 27H of the Principal Act in respect of an annuity that is not an "eligible annuity".

Paragraph (e) of clause 3 will replace the definition of "unused undeducted purchase price" in sub-section 27A(1) of the Principal Act. Paragraph (a) of the new definition is in the same terms as the existing definition but applies only where paragraph (b) or (c) of the definition does not apply. Paragraphs (b) and (c) apply where an annuity or superannuation pension which is commuted, or is terminated with payment of a residual capital value, was purchased wholly or in part by way of the roll-over of an eligible termination payment. The significance of unused undeducted purchase price is that it is deducted from a commutation or residual capital value

payment in ascertaining the amount of an eligible termination payment. The amount so deducted is received tax-free. Paragraph (b) of the new definition will specify that the unused undeducted purchase price of an annuity or pension will be NIL where the purchase price of the annuity or pension consisted wholly of a rolled-over eligible termination payment.

Paragraph (c) of the proposed new definition of unused undeducted purchase price will apply where the purchase price of the annuity or superannuation pension consisted partly of a rolled-over eligible termination payment. In these cases, the effect of the formula in the paragraph is that the unused undeducted purchase price will be so much of the undeducted purchase price as did not consist of rolled-over components of eligible termination payments (component A), less the part of any annual amounts (called deductible amounts) excluded from assessable income as representing the recovery of the part of the undeducted purchase price that did not consist of rolled-over components of eligible termination payments (component B). Component B is described as the aggregate of the "non roll-over deductible amounts" (see the notes on paragraphs (c) and (n) of this clause). By sub-clauses 9(4) and 9(5), the changes to the definition of unused undeducted purchase price are to apply to the commutation of annuities and payments of the residual capital value of annuities after 18 February 1985 (the date on which this proposal was announced) and to the commutation of superannuation pensions and payments of the residual capital value of superannuation pensions after the date on which this Bill was introduced into the Parliament.

Paragraph (f) of clause 3, which will insert new sub-section 27A(2A), is consequential upon the amendment being made by paragraph (e) to replace the definition of unused undeducted purchase price. The new sub-section is needed because, once the amended law prevents a rolled-over eligible termination payment being returned as tax-free unused undeducted purchase price upon the commutation, or termination with residual capital value, of an annuity or pension, the eligible termination payment resulting from the commutation or residual capital value may then have as a component some part of the concessional component of the rolled-over eligible termination payment.

Sub-section 27A(2A) will ensure that the concessional component of the eligible termination payment received upon commutation, or as the residual capital value, does not include so much of any undeducted purchase price recouped in the course of receiving regular annuity or pension payments (called deductible amounts in section 27H) as represents the concessional component of the undeducted purchase price. Paragraph (a) of sub-section (2A) identifies the amount of the concessional component in

any eligible termination payment that was rolled-over in purchasing the annuity or pension. Paragraph (b) identifies the amounts calculated under proposed new sub-section 27A(16) (see the notes on paragraph (n) of this clause) as the parts of any deductible amounts attributable to such a component. The remaining concessional component rolled-over may form part of the commutation, etc. payment and so be included in assessable income to the extent of 5%.

Paragraph (g) of clause 3 will insert 3 new sub-sections in section 27A of the Principal Act. New sub-section 27A(5A) will apply for the purposes of paragraph (d) of the definition of "eligible termination payment", which treats an amount received on the commutation of a superannuation pension as a taxable eligible termination payment. The new sub-section will ensure that any consideration received or receivable by a taxpayer for the assignment or transfer of a right to a superannuation pension or part of a superannuation pension will be treated as a taxable commutation payment. New sub-section 27A(5B) will do likewise in respect of any assignment or transfer of an annuity which, if commuted, would give rise to an eligible termination payment as defined in paragraph (g) of the definition. By sub-clause 9(7), the two new sub-sections are to apply to assignments or transfers after the date on which this Bill was introduced into the Parliament.

The third new sub-section to be inserted by paragraph (g) of clause 3 is sub-section 27A(5C). The insertion of that sub-section is for clarification purposes only and is not intended to imply that the existing law has a different effect.

It has been suggested that the words "contributions made by any person" in the definition of purchase price in sub-section 27A(1) of the Principal Act allow contributions by a non-taxable employer (for example, a government authority) to qualify as part of the tax-free component of a superannuation pension or annuity paid to a taxpayer. That suggestion is contrary to the intended operation and philosophy of the amendments made last year. The inclusion of those words in the definition was designed overcome a limitation in former section 26AA that prevented contributions by a deceased fund member to purchase a pension payable to a surviving dependant from being treated as part of the tax-free capital component of the survivor's pension. It was not intended that non-deductible employer contributions could qualify as undeducted purchase price. The insertion of new sub-section 27A(5C) will make the original intention clear.

Paragraph (a) of the new sub-section will ensure that superannuation fund contributions by an employer, or another person on behalf of the employer, to obtain superannuation benefits for an employee do not qualify as

part of the purchase price to be taken into account in ascertaining the amount of a superannuation pension that is assessable to the employee under section 27H of the Principal Act. Paragraph (b) of new sub-section (5C) will operate to the same effect in relation to payments made by an employer, or another person on behalf of the employer, to purchase an annuity for an employee. By sub-clause 9(2), the new sub-section will apply to relevant contributions and payments made after the date on which the Bill was introduced into the Parliament.

Paragraph (h) of clause 3 proposes the substitution of existing sub-section 27A(7) of the Principal Act with a new sub-section 27A(7). Paragraph (a) of the new sub-section will restate the existing provision.

Paragraph (b) of new sub-section 27A(7) (also a clarifying amendment) will apply in a similar way in respect of the defined term "undeducted contributions" as new sub-section 27A(5C) (being inserted by paragraph (g) of this clause) will apply in respect of the purchase price of a superannuation pension or annuity. Paragraph (b) will make it clear that any contributions made to a superannuation fund by an employer, or another person on behalf of the employer, are not to be treated as part of the tax-free "undeducted contributions" component of any superannuation benefits arising from those contributions that are paid to an employee of the employer. The amendment will, under sub-clause 9(2), apply to contributions made after the date on which the Bill was introduced into the Parliament.

Paragraph (c) of sub-section (7) has a function which parallels that of new sub-section 27A(2A) being inserted by paragraph (f) of this clause. The explanatory note on that sub-section has equal application in this context, except that paragraph (c) applies to the undeducted contributions component of the rolled-over eligible termination payment. Sub-paragraphs (c)(i) and (ii) have an equivalent operation to paragraphs 27A(2A)(a) and (b). The undeducted contributions component of the rolled-over eligible termination payment that remains after paragraph 27A(7)(c) applies may form part of the commutation, etc. payment and so be received tax-free.

Existing sub-section 27A(8), which performs a similar function to section 21 of the Principal Act, applies to deem an eligible termination payment that is not in cash to be a payment of the value of the property transferred. In order that any consideration paid to obtain such an eligible termination payment may be taken into account, paragraph (j) of clause 3 proposes the insertion of new sub-section 27A(8A). That sub-section will reduce the amount of any "non-cash" eligible termination payment to which paragraph (a) of the definition of eligible termination payment applies (that

is, payments made in consequence of the termination of a taxpayer's employment) by the amount or value of any consideration provided to obtain the payment. This will mean that, where for example a taxpayer receives a "golden handshake" in the form of a parcel of shares, any consideration paid by the taxpayer for the shares will be taken into account in determining the net amount subject to tax. Under sub-clause 9(8), this amendment will apply to eligible termination payments made on or after 1 July 1983.

The function of sub-section 27A(10) of the Principal Act is to ensure that, where an eligible termination payment is partly preserved by way of roll-over into a superannuation fund or approved deposit fund, or applied in purchasing an annuity from a life assurance company or registered organisation, any part of the eligible service period occurring before 1 July 1983 is preserved only to the same extent as the component of that payment that is referable to the period of service that occurred before 1 July 1983 (the "pre-July 1983 component") is preserved. The existing sub-section 27A(10) is technically defective in that it has no effect where none of the pre-July 1983 component is rolled-over. Paragraph (k) of clause 3 will repeal the existing sub-section 27A(10) and substitute a new sub-section 27A(10) which overcomes the defect. As announced on 22 January 1985, the amendment is to apply from 1 July 1983 (sub-clause 9(9)).

Paragraph (a) of the new sub-section limits its application to cases where only part of an eligible termination payment is rolled-over in the manner described above. Where such a payment is rolled-over in full, other provisions - in particular, paragraph (d) of the definition of "relevant service period" in sub-section 27A(1) - ensure that the whole of the pre-July 1983 eligible service period is counted when a subsequent eligible termination payment is made that is attributable to the one rolled-over. Paragraph (b) is simply a drafting statement that the sub-section only applies where the eligible service period attached to the rolled-over eligible termination payment commenced before 1 July 1983.

The formula in the new sub-section shortens the pre-July 1983 portion of the eligible service period to be carried forward and counted as a relevant service period in relation to a future eligible termination payment that is attributable to the one rolled over. It does this by removing from the beginning of the pre-July 1983 portion of the eligible service period the number of days calculated by applying to that portion the ratio in which the pre-July 1983 component of the eligible termination payment is not rolled-over. Hence, in the formula, component -

A is the pre-July 1983 part of the eligible service period;

- B is the pre-July 1983 component of the eligible termination payment; and
- C is the part of the pre-July 1983 component of the eligible termination payment that is rolled-over.

The effect of the amendment to paragraph 27A(12)(c) of the Principal Act proposed by paragraph (m) of clause 3 will be to ensure that, if an eligible termination payment is rolled-over and used to purchase a deferred annuity, the roll-over will not cause the eligible termination payment to be freed from tax unless the deferred annuity is also an "eligible annuity" - that is, one purchased wholly from a rolled-over eligible termination payment.

Without that requirement, it would be possible to escape tax entirely by purchasing a deferred annuity with the rolled-over eligible termination payment, plus a small amount of other moneys, and subsequently commuting the annuity to cash. The commutation would not be a taxable eligible termination payment because it would not constitute the commutation of an "eligible annuity" as required by paragraph (g) of the definition of eligible termination payment. Under sub-clause 9(10) the amendment is to apply to payments made to purchase annuities after the date on which this Bill was introduced into the Parliament.

Paragraph (n) of clause 3 will insert two new sub-sections in section 27A. New sub-section 27A(15) concerns the requirement that, in order to qualify as an approved deposit fund, a fund must satisfy certain tests of establishment. Those tests are that the fund was established as an indefinitely continuing fund and solely for approved purposes, and that the rules of the fund immediately after establishment were approved rules. Inadvertent failure by a fund to satisfy one or more of those tests means that eligible termination payments rolled-over into such a fund are not freed from tax.

To overcome the strict application of the law in that way in circumstances where a fund has, by oversight, failed to meet any of the statutory establishment tests, new sub-section (15), effective from 1 July 1983 (sub-clause 9(11)), will enable the fund to be treated as an approved deposit fund if the trustee of the fund satisfies the Commissioner of Taxation that, due to special circumstances that existed at the time of establishment, it would be reasonable to treat the fund as an approved deposit fund.

Paragraph (n) also inserts proposed new sub-section 27A(16). This sub-section deems an amount that is a deductible amount under section 27H to consist of the component parts of the undeducted purchase price of the relevant annuity or superannuation pension and in the proportions that these components are present in the undeducted purchase price. The sub-section will apply only where the purchase price consists at least partly of an eligible termination payment rolled-over. A deductible amount is an annual amount excluded from an annuity or pension upon assessment, on the basis that the amount represents the return of an appropriate portion of the undeducted purchase price of the annuity or pension. The components of the purchase price of an annuity or pension that may form part of the undeducted purchase price are:

- . pre July 1983 component) these are components of
- . concessional component) a rolled-over eligible
- . undeducted contributions) termination payment
- . amounts that do not have
their source in rolled-over
eligible termination
payments.

There is a twofold purpose in breaking down each deductible amount into whichever of these four components are present in the undeducted purchase price. First, where paragraph (c) of the proposed new definition of unused undeducted purchase price applies (see the notes on paragraph (e) of this clause), component B of the formula in the definition excludes from unused undeducted purchase price so much of any deductible amount as consists of the component of the undeducted purchase price that did not have its source in rolled-over eligible termination payments. This part of a deductible amount is the "non roll-over deductible amount" (see the notes on paragraph (c) of this clause). Secondly, the purpose of sub-section 27A(16) is to identify the extent to which each deductible amount consists of the three components of any rolled-over eligible termination payment used to purchase the annuity or pension, so that the undeducted contributions component and concessional component of any eligible termination payment resulting from the commutation or residual capital value of the annuity or pension can exclude any part of a deductible amount that is attributable to those components of the undeducted purchase price (see the notes on sub-sections 27A(2A) and (7)). By reason of sub-clause 9(4), new sub-section 27A(16) applies to the commutation of annuities and payments of the residual capital value of annuities after 18 February 1985 (date of announcement) and to the commutation of superannuation pensions and payments of the residual capital value of superannuation pensions after the date on which this Bill was introduced into the Parliament.

Clause 4 : Approved early retirement scheme payments

Section 27E of the Principal Act contains rules for determining whether an eligible termination payment qualifies as an approved early retirement scheme payment and the extent to which such a payment may be treated as a "concessional component" of the eligible termination payment, only 5% of which is included in the taxpayer's assessable income. Where the tax liability on that component is deferred by way of a roll-over, the component retains its identity for the purpose of any future application of Subdivision AA to a payment that is attributable, wholly or in part, to the rolled-over concessional component.

Clause 4 will amend section 27E to change two of the existing conditions for qualification of an eligible termination payment as an approved early retirement scheme payment. The first of these changes relates to the test of premature termination of employment. The second relates to the requirement dealing with agreements between the taxpayer and the employer, or between the employer and some other person, to employ the taxpayer. A further amendment proposed to section 27E by clause 4 will require that the current value of retirement benefits forgone by reason of early retirement be taken into account for the purpose of determining the amount that the taxpayer would have received if employment had been terminated other than in accordance with the early retirement scheme arrangements.

Paragraph (a) of clause 4 is a drafting change consequential on the insertion, by paragraph (e) of clause 4, of proposed new sub-section 27E(5). By paragraph (a), "sub-section" in paragraph 27E(4)(a) will be omitted and "section" substituted. This change is necessary because the term "termination time", presently used only in sub-section (4), is also to be used in new sub-section 27E(5).

Sub-section 27E(4) provides that, where the requirements of the sub-section are satisfied, so much of an eligible termination payment received as a consequence of an early retirement scheme as exceeds the amount the taxpayer could otherwise be expected to have received on resignation qualifies as an approved early retirement scheme payment.

One of the requirements of sub-section 27E(4), contained in paragraph (b), is that the termination of employment has occurred before the date on which the employment of the taxpayer could "normally" have come to an end. Where, in the industry in which the taxpayer was employed, there are arrangements under which retirement occurs, or may occur, at an age earlier than the community

norm by reason of the taxpayer having attained a particular age or completing a particular period of service, the termination of employment must occur before that date for section 27E to apply.

In those circumstances, a payment could not be an approved early retirement scheme payment where the taxpayer's employment was terminated after the expiry of either of those periods. Where there are no such circumstances, the taxpayer's employment need only to have been terminated before age 65.

By paragraph (b) of clause 4, existing paragraph (b) of sub-section 27E(4) is to be omitted and replaced by a new paragraph (b). The effect will be that, instead of the existing test of premature termination of employment as explained above, termination of employment under an approved early retirement scheme will be premature if it occurs before age 65 and before the time that, under the particular terms of employment, the taxpayer's employment would necessarily have had to terminate. As is presently the case, if there are no such terms of employment, the taxpayer's employment will need to have terminated before age 65. This amendment is to apply to eligible termination payments made on or after 1 July 1983 (sub-clause 9(12)).

Another of the requirements of section 27E is that, at the time employment terminates, there is no agreement in force between the taxpayer and the employer, or the employer and another person, to employ the taxpayer. That condition is contained in paragraph 27E(4)(d). Paragraph (c) of clause 4 proposes to amend paragraph 27E(4)(d) (by sub-clause 9(13), with effect from 1 July 1983) to make it clear that the agreement referred to in that paragraph is an agreement to employ the taxpayer after termination of employment.

Paragraph (d) of clause 4 is a drafting measure consequential on the insertion, by paragraph (e), of proposed new sub-section (5) in section 27E. The concessional taxing treatment for early retirement scheme payments applies only to so much of the amount that the taxpayer receives at the time of early retirement as exceeds the amount which the taxpayer could be expected to have received if termination of employment had occurred at that same time otherwise than by reason of early retirement. The amendment to sub-section 27E(4) proposed by paragraph (d) facilitates the reference to that amount (called the "termination amount") in the proposed new sub-section.

As mentioned, the concessional treatment afforded approved early retirement scheme payments under section 27E applies to so much of the amount received on termination of

employment as exceeds the amount of an eligible termination payment that could reasonably be expected to have been received if employment had terminated at that time otherwise than in accordance with the early retirement scheme - for example, on resignation.

In some cases, there may be no such amount - for example, where the employee has not yet qualified for pension benefits. Nevertheless, it will often be the case that the early retirement payment is made (at least in part) to compensate the retiree for the loss of benefits such as a pension, particularly where early retirement is not very far in advance of expected retirement. Accordingly, by new sub-section 27E(5) being inserted by paragraph (e) of clause 4, the amount of an eligible termination payment that could reasonably be expected to have been made on termination of employment otherwise than by reason of early retirement (the "termination amount") will include such part (the "forgone benefit part") of an early retirement scheme payment as the Commissioner of Taxation considers it appropriate to regard as having been made in lieu of superannuation benefits to which the retiree may otherwise have been, or have become, entitled. Under sub-clause 9(14), this amendment is to apply to eligible termination payments made in relation to a termination of employment after the date on which the Bill was introduced into the Parliament.

Clause 5 : Bona fide redundancy payments

Section 27F of the Principal Act applies to bona fide redundancy payments in a similar manner as section 27E applies to approved early retirement scheme payments - see notes on clause 4 - and the amendments to section 27F proposed by this clause are on all fours with those that clause 4 proposes in relation to section 27E.

As mentioned in the notes on clause 4, there are to be three substantive changes. The first, to be effected by paragraph (b) and applicable to eligible termination payments made on or after 1 July 1983, is that the existing test of premature termination of employment will be replaced by one that has regard to whether termination occurs before age 65 and before a time when, under the particular terms of employment, the taxpayer's employment would necessarily have had to cease. The second, by paragraph (c) and effective from 1 July 1983, makes it clear that a reference in paragraph 27F(1)(d) to an agreement to employ the taxpayer is a reference to an agreement to employ the taxpayer after the termination of employment caused by the redundancy. The third change, being made by paragraph (e) and applicable to eligible termination payments made in relation to a termination of employment after the date on which this Bill was introduced into the Parliament, will enable superannuation benefits

forgone in lieu of a redundancy payment to be treated, in appropriate cases, as part of an eligible termination payment that the taxpayer could reasonably be expected to have received on voluntary retirement instead of on termination of employment by redundancy.

Clause 6 : Assessable income to include annuities and superannuation pensions

Section 27H of the Principal Act provides for the inclusion in assessable income of annuities (including superannuation pensions) that commence to be paid on or after 1 July 1983. It also contains rules for deducting from an annuity the amount calculated by dividing that part of the purchase price of the annuity that has not attracted a tax deduction (the "undeducted purchase price") by the "relevant number".

Where an annuity is payable for a specific number of years, or only during the lifetime of the annuitant, the "relevant number" equals, respectively, that specific number of years or the number of years in the life expectation of the person. The Commissioner of Taxation may, however, vary the amount by which an assessable annuity is reduced if of the opinion that the otherwise determined amount is inappropriate. In varying that amount, the Commissioner may have regard to any special terms and conditions of the annuity, an actuary's certificate relating to the undeducted purchase price of the annuity and any other matters considered relevant.

On the other hand, where an annuity is not payable for a fixed term or over the annuitant's lifetime, the Commissioner is required to calculate the relevant number - and hence the amount by which an assessable annuity is to be reduced - having regard to five different criteria, including the number of years the annuity may reasonably be expected to be payable and any changing circumstances as between one year and the next.

Clause 6 will amend section 27H to remove some of its complexity and enable the Commissioner to vary the reduction in any assessable annuity on the same basis as is presently provided in respect of fixed term or single lifetime annuities. The clause will also amend the section to insert a new sub-section to specifically limit the reduction in an assessable annuity where part of that annuity has previously been commuted.

Paragraphs (a) and (b) of clause 6 are drafting measures consequential on the insertion in section 27H of new sub-section (3A).

By paragraph (c) of clause 6, existing sub-section 27H(3) is to be omitted and a new sub-section 27H(3) substituted. The new sub-section is essentially a restatement of the existing sub-section but omitting references which limit its application to annuities covered by paragraph (a) (fixed term annuities) and paragraph (b) (single lifetime annuities) in the definition of "relevant number" in sub-section (4). The effect will be that the Commissioner will be able to vary the "deductible amount" applicable to all annuities on the same basis as is presently provided by sub-section (3) in respect of fixed term or single lifetime annuities. This amendment will apply in 1985/86 income tax assessments and those of subsequent years (sub-clause 9(15)).

Paragraph (c) of clause 6 will also insert a new sub-section (3A) in section 27H. The sub-section will authorise the Commissioner of Taxation to reduce the deductible amount that would otherwise be excluded from an annuity or pension upon assessment. The reduction may have regard to the matters listed in the four paragraphs of the new sub-section and may take place only following a partial commutation of a larger annuity or pension of which the annuity or pension being assessed forms a part. Paragraph (a) allows regard to be had to the extent to which the unused undeducted purchase price of the annuity or pension has been used by the taxpayer to reduce the partial commutation payment in determining the size of the eligible termination payment resulting from the partial commutation. This acknowledges that the annual exclusion from the reduced annuity or pension (the deductible amount) on account of recouped undeducted purchase price ought not ignore the fact that a part of that undeducted purchase price has already been recouped upon partial commutation. Paragraph (b) of sub-section (3A) allows the Commissioner to take into account, in assessing the post-commutation annuity or pension, the fact that the eligible termination payment resulting from the partial commutation payment has consisted of - and therefore recouped - components of the undeducted purchase price that had their source in a rolled-over eligible termination payment. The relevant components are:

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

Paragraph (c) allows regard to be had to the fact that the pre-commutation annuity or pension has already had excluded from it annual deductible amounts that represented the recoupment of some of the undeducted purchase price. Paragraph (d) allows other relevant matters, such as how much of the original term remains and the fact that a partial commutation has occurred during a particular year of income, to be considered in ascertaining the deductible amount.

By sub-clause 9(16), new sub-section 27H(3A) will apply where the partial commutation of an annuity occurs after 18 February 1985 or where the partial commutation of a superannuation pension occurs after the date on which this Bill was introduced into the Parliament.

Consistent with the proposed substitution, by paragraph (c) of this clause, of new sub-section 27H(3), paragraph (d) will substitute a new paragraph (c) of the definition of "relevant number" in sub-section 27H(4). The existing paragraph specifies 5 criteria to be taken into account in determining the "relevant number" in relation to an annuity that is not payable for a fixed term or during a single person's lifetime. The new paragraph will contain the single test of the number of years in the period during which the annuity is expected to be payable. The other 4 existing criteria will, where relevant, be taken into account in any application of new sub-section 27H(3). This amendment will apply in assessments for the 1985/86 and subsequent years of income (sub-clause 9(15)).

Clause 7 : Rebate in respect of annual leave, long service leave and eligible termination payments

Among other things, section 160AA of the Principal Act provides a rebate of tax to reduce to 15% the effective rate of tax on the first \$50,000 of the fully assessable "post-June 1983" components of assessable eligible termination payments made to taxpayers aged 55 or more.

However, because the application of the 15% rate is in effect expressed as being conditional on the person who received the eligible termination payment having attained the age of 55 years, the rebate is not available in respect of an eligible termination payment received by the trustee of the estate of a deceased taxpayer even though, had the taxpayer lived, he or she would have been entitled to it. The amendments to section 160AA proposed by clause 7 will enable an appropriate rebate to be allowed in cases of that kind. Under sub-clause 9(17), the amendments are to apply to eligible termination payments received by the trustee on or after 1 July 1983.

New sub-section 160AA(3), being inserted by clause 7, will apply where an eligible termination payment made in respect of a deceased taxpayer has been included in the assessable income of the trust estate of that taxpayer.

In those circumstances, the trustee is, by paragraph (a) of the sub-section, to be treated as a taxpayer who is the same age that the deceased was at the time of death, and who has had the eligible termination payment included in assessable income. That is, the trustee is, for the purposes of section 160AA, effectively treated as the deceased taxpayer in relation to the payment.

New paragraph (3)(b) will apply for the purposes of the definition of "residual amount" in sub-section 160AA(2). By reference to the "residual amount", sub-section 160AA(1) applies to ensure that the 15% tax rate applies only to the first \$50,000 of the fully assessable "post-June 1983" components of eligible termination payments made to a taxpayer aged 55 or more. The term "residual amount" is defined to mean \$50,000 or that amount reduced by any earlier fully assessable components of eligible termination payments made to the taxpayer on or after attaining age 55. Paragraph (b) of new sub-section 160AA(3) will provide that eligible termination payments assessed to the deceased taxpayer during his or her lifetime and on or after age 55 are to be treated as prior payments to the trustee of the deceased's estate for the purpose of ascertaining the "residual amount" in relation to the trustee.

Clause 8 : Interpretation

Clause 8 will amend the pay-as-you-earn (PAYE) provisions of the Principal Act to require tax instalment deductions to be made from annuities and supplements to annuities or pensions.

The definition of "salary or wages" in sub-section 221A(1) of the Principal Act includes eligible termination payments and any payments made by way of superannuation, pension or retiring allowance. Tax instalment deductions, calculated in accordance with rates that are prescribed by regulation, are required to be made from payments that fall within that definition.

By clause 8 of the Bill, paragraph (c) of the definition of "salary or wages" in sub-section 221A(1) of the Principal Act will be amended to include payments of annuities, and supplements to annuities or pensions, and so bring those payments within the scope of the PAYE provisions of the law. That amendment will, by sub-clause 9(18), apply to annuities and supplements paid on or after the first day of the second month following that in which the Bill receives Royal Assent.

Clause 9 : Application of amendments

This clause, which will not amend the Principal Act, will specify the year of income in which, or the dates from which, the various amendments proposed in the Bill will first apply. An explanation of the application provisions proposed is contained in the notes on the clauses to which each of the sub-clauses of clause 9 applies.

Clause 10 : Deductions from eligible termination payments

The amendments contained in the Bill will mean, in some cases, that the amount to be treated as a taxable eligible termination payment for tax instalment deduction purposes is more or less than otherwise would have been the case. Clause 10, which will not amend the Principal Act, will ensure that any changes of that kind do not impose any additional or retrospective PAYE obligations on employers in relation to eligible termination payments made before the first day of the second month following that in which the Bill receives Royal Assent.

Clause 11 : Application of Income Tax Assessment Amendment Act (No. 3) 1984

The amendments proposed by this clause are of a purely technical kind and correct a drafting error in application clauses contained in the Income Tax Assessment Amendment Act (No. 3) 1984. Specifically, sub-sections 60(4) and (7) of that Act each contained a reference to paragraph 29(c) that should have been a reference to paragraph 29(d). This clause will, in effect, correct those errors.

Clause 12 : Amendment of assessments

Clause 12, which will not amend the Principal Act, is a standard measure that will ensure that the Commissioner of Taxation has authority to re-open an income tax assessment made before the Bill becomes law if that should be necessary in order to give effect to the various amendments it contains.

