



GUIDANCE NOTE 464

DETERMINATION OF ALLOCATED SURPLUS AMOUNTS FOR THE PURPOSES OF THE SUPERANNUATION CONTRIBUTIONS TAX (ASSESSMENT AND COLLECTION) ACT

1. INTRODUCTION

APPLICATION

Actuaries who are providing advice for accumulation funds in relation to the determination of “Allocated Surplus Amounts” as defined in Section 43 of the Superannuation Contributions Tax (Assessment and Collection) Act 1997 and Section 38 of the Superannuation Contributions Tax (Members of Constitutionally Protected Superannuation Funds) Assessment and Collection Act 1997.

The principles and approaches set out in this Guidance Note are solely for the purposes of determining “Allocated Surplus Amounts” (ASAs). They are not necessarily appropriate for any other purpose.

Except as set out in Section 6, this Guidance Note provides advice only in respect of accumulation funds as the term “Allocated Surplus Amounts” is not applicable to defined benefit funds in the legislation referred to above.

Section 6 of this Guidance Note provides guidance to actuaries who are determining Notional Surchargeable Contribution Factors for defined benefit funds with “accumulation only” or “accumulation add-on” benefits.

Superannuation Contributions Ruling SCR 97/1 issued by the Australian Taxation Office sets out that members of defined benefit schemes with accumulation only benefits should be treated consistently with members of accumulation schemes.

SCR 97/1 does not apply the same principles to “accumulation add-on” benefits. Nevertheless, the Institute considers that applying similar treatment to such “add-on” benefits would be consistent with Australian actuarial practice. Any certification under the relevant legislation requires the Certificate to be prepared in accordance with Australian actuarial

practice.

Therefore, the principles and approaches set out in this Guidance Note can also be used by actuaries in relation to determining Notional Surchargeable Contributions for “accumulation only” and “accumulation add-on” benefits in defined benefit funds.

LEGISLATION

The Superannuation Contributions Tax (Assessment and Collection) Act 1997 and the Superannuation Contributions Tax (Members of Constitutionally Protected Superannuation Funds) Assessment and Collection Act 1997 require trustees to obtain actuarial advice in certain circumstances relating to the determination of “Allocated Surplus Amounts” in respect of periods commencing on or after 1 July 1997. “Allocated Surplus Amounts” must be determined in accordance with Australian actuarial practice.

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CLASSIFICATION

This Guidance Note is issued to assist actuaries to comply with the provisions of the Superannuation Contributions Tax (Assessment and Collection) Act 1997 and the Superannuation Contributions Tax (Members of Constitutionally Protected Superannuation Funds) Assessment and Collection Act 1997 when required to provide advice in relation to the reporting of “surchargeable contributions” under those Acts.

Compliance with the legislation is clearly mandatory. However this Guidance Note is not classified as mandatory as it is designed to assist actuaries meet the requirements of the legislation. Accordingly, departure from this Guidance Note would not, in itself, necessarily be viewed as unprofessional conduct. However, where an actuary departs from the GN, he or she must be able to demonstrate that there were reasonable grounds for such departure.

In view of the recent introduction of the relevant legislation, it is intended that consideration will be given to revising this Guidance Note once actuaries have gained some experience of working with it.

ALLOCATED SURPLUS AMOUNTS (ASAs)

From 1 July 1997, “Allocated Surplus Amounts” in accumulation funds are treated as surchargeable contributions. An Allocated Surplus Amount is defined in Section 43 of the Superannuation Contributions Tax (Assessment and Collection) Act as follows:

***Allocated Surplus Amount**, in relation to a member of a superannuation fund in relation to a financial year, means an amount that is allocated by the relevant superannuation (accumulated benefits) provider for the benefit of the member in respect of the financial year (other than an amount paid for or by the member to the provider) to the extent to which the allocated amount exceeds an amount that, in the opinion of an eligible actuary according to Australian actuarial practice, is reasonable having regard to:*

- a) the amounts paid by or for the member to the provider; and*
- b) the fund’s investment earnings relating to the member’s interest in the fund; and*
- c) any other relevant matters.*

EXPLANATORY MEMORANDUM

The Explanatory Memorandum to the amending legislation which introduced the definition of ‘allocated surplus amounts’ states:

An allocation would be reasonable if, for example, it represents an ordinary return on investment. An amount allocated from fund surplus which substantially increased a member’s benefit, for example, would be an unreasonable allocation that is an allocated surplus amount.

2. GENERAL PRINCIPLES

This Guidance Note is based on the following general principles:

1. where surplus, irrespective of its source, is used to meet an employer’s contribution liabilities, the amount should be treated as an Allocated Surplus Amount when allocated;
2. where surplus derived from unallocated employer contributions made after the first annual review date on or after 30 June 1997 (including investment earnings on such contributions) is allocated for the benefit of a member, the amount allocated should be treated as an Allocated Surplus Amount in the year of allocation;
3. where any surplus is being allocated or otherwise used for the benefit of members in an inequitable manner, the excess of the

amount allocated over the amount the actuary considers equitable should be treated as an Allocated Surplus Amount when allocated;

4. where any surplus being allocated has arisen from investment earnings on members' account balances (both accrued at 1 July 1997 and subsequent earnings) such allocations should not be surchargeable provided that the distribution is equitable. Surplus distributions arising from investment earnings on the three types of reserve accounts as set out in this Guidance Note should be treated in the same way as a distribution from the respective type of reserve account;
5. where any surplus being allocated has arisen from charges to accounts for insurance or administration exceeding the actual costs and where the charges have been included in whole or in part in surchargeable contributions, such allocations should not be surchargeable;
6. the determination of the various components of surplus is generally a difficult issue and a precise determination may not be possible even after considerable time and expense. It is, therefore, appropriate for an actuary to use whatever approximations he or she considers reasonable.

In cases where this Guidance Note does not fully cater for the particular issue, the Actuary should take these general principles into account. These general principles should also be taken to override anything else in this Guidance Note which may be construed, in particular circumstances, to be contrary to these general principles.

3. TYPES OF SURPLUS

Surplus can arise in an accumulation scheme from a variety of sources. These include:

1. Excess investment earnings
2. Unallocated contributions
3. Forgone benefits
4. Conversion from Defined Benefit to accumulation
5. Miscellaneous

In addition there may be pre-existing surplus which has arisen in the past due to one or more of the above reasons.

4. SURCHARGEABLE AND NON-SURCHARGEABLE ACCOUNTS

At any date, the total surplus in a fund can be determined as the net market value of the fund's assets less the total of members' account balances.

In order to ascertain whether amounts allocated from surplus are to be treated as ASAs, records should be maintained that would enable the total surplus to be divided into 3 "accounts" as follows:

1. Investment Reserve
2. Contribution Reserve
3. Miscellaneous Reserve

These Reserves may be maintained for surcharge purposes and may differ from the Reserves required for other purposes.

Where the actuary considers that the operation of the fund is such that the spirit of this Guidance Note can be met without maintaining some or all of these Reserve Accounts, it is not necessary for such accounts to be maintained. For example, this would apply if all benefits are fully vested and no unallocated contributions are made.

INVESTMENT RESERVE (IR)

Opening Balance

The opening balance of this reserve will consist of any amount which the actuary considers is appropriate and includes any amounts which have arisen from the smoothing of investment returns.

In order to simplify the initial calculations, as at the first annual review date on or after 30 June 1997 an amount equal to the lesser of

- a) the total surplus at that date; AND
- b) 15% of the net market value of assets at that date

can be certified by the actuary as an IR regardless of how the reserves in the fund may otherwise be classified at that date.

Where considered reasonable by the actuary, after taking into account the general principles in Section 2 and after suitable analysis of the pre-existing surplus, an amount higher than 15% of the net market value can be classified as the IR component.

If considered appropriate, an actuary could determine a lower Investment Reserve than that allowed by this section. This would lead to a greater opening balance in the Miscellaneous Reserve.

Updating Balance

The IR would be adjusted each year to take into account :

- a) any allocations to the IR resulting from the smoothing of investment returns; plus
- b) investment earnings on the IR; plus
- c) any IR component of a transfer amount from another fund; less
- d) any allocations from the IR.

The IR component of a transfer amount from a defined benefit fund can be determined without the need for further analysis as the lesser of

- a) the amount transferred less the initial member account balances in respect of the transfer amount; AND
- b) 15% of the amount transferred.

Where considered reasonable by the actuary, after taking into account the principles in Section 2, an amount higher than 15% of the amount transferred can be classified as the IR component.

CONTRIBUTION RESERVE

Opening Balance

The opening balance of this Reserve (as at the first annual review date on or after 30 June 1997) will be zero.

Updating Balance

This reserve would be adjusted to take into account :

- a) any unallocated contribution made to the fund after the first annual review date on or after 30 June 1997; plus
- b) investment earnings on the Contribution Reserve; less
- c) any allocation from the Contribution Reserve; less
- d) any contribution tax applicable in respect of contributions to the Contribution Reserve.

For the purpose of item (b), investment earnings on amounts moving in or out of this reserve during a year can be ignored.

MISCELLANEOUS RESERVE

Opening Balance

The opening balance of this reserve (as at the first annual review date on or after 30 June 1997) will be the balance of the initial surplus, if any, i.e. the portion not allocated to the Investment Reserve.

Updating Balance

At any date the Miscellaneous Reserve will equal the balance of the total surplus, i.e. the portion not allocated to the Investment Reserve and the Contribution Reserve. This will include any forgone benefits arising after the first annual review of the fund on or after 30 June 1997.

5. TREATMENT OF ALLOCATIONS FROM RESERVE ACCOUNTS

ALLOCATIONS FROM INVESTMENT RESERVE

Amounts distributed from this Reserve will not be ASAs if the actuary considers that

- a) the distribution is equitable, and
- b) the distribution is in the form of an additional interest credit or is an amount proportional to members' accounts.

A particular distribution would not necessarily be considered to have failed to meet the tests in (a) and (b) above just because a different additional interest rate (or a different proportion) was used for different classes of membership. The actuary would need to consider allowing for the fund's benefit design and which classes of member generated the surplus. Different additional interest rates may be particularly appropriate if different investment fluctuation reserves have been generated by different investment options or policies within the fund.

Where an allocation is being made in proportion to members' accounts, the allocation should usually be based on the account balances at the end of the fund's previous financial year.

Allocations of IR amounts in other ways, such as to meet an employer's contribution liabilities, would be treated as ASAs in a similar manner to distributions from the Contributions Reserve.

ALLOCATIONS FROM CONTRIBUTIONS RESERVE

All allocations from this reserve would be treated as ASAs. This will apply whether the amounts are credited to members' accounts or used to meet insurance or other expenses including any surcharge payable. Only the amount allocated from the Contribution Reserve should be treated as an ASA even though an amount grossed up for contribution tax may be reported to members as a notional employer contribution with a notional deduction for contribution tax of 15%.

Where the amounts are used to pay insurance/expenses, the amounts should be apportioned between members in a reasonable manner. If the actuary considers that it is appropriate to smooth the amounts treated as ASAs from year to year, this would be acceptable.

ALLOCATIONS FROM MISCELLANEOUS RESERVE

Allocations from this Reserve will be considered to be ASAs unless the actuary considers that:

EITHER

1

- a) the distribution is equitable; and
- b) the distribution is in the form of an additional interest credit or is an amount proportional to members' accounts; and
- c) the additional interest rate credited is not more than 5% in any year or the amount credited in any year is not more than 5% of a member's account. (Only the excess over 5% would be treated as an ASA provided that points (a) and (b) are satisfied.)

OR

2

- a) the distribution is equitable; and
- b) the distribution is an amount proportional to insurance premiums and/or administration charges or amounts being debited or previously debited to members' accounts for insurance premiums or administration charges; and
- c) the proportion does not exceed 100% of one year's premium or administration charge, as appropriate OR the allocation is consistent with General Principle 5. (Only the excess over the limit specified in this sub-point would be treated as an ASA provided that points (a) and (b) are satisfied.)

OR

3

A combination of 1 and 2 above provided that the total amount distributed does not exceed 5% of the total of all members' account balances.

A particular distribution would not necessarily be considered to have failed to meet the tests in 1, 2 or 3 above just because a different additional interest rate (or a different proportion) was used for different classes of membership. In determining whether or not the tests are satisfied, the actuary would need to consider allowing for the fund's benefit design and which classes of member generated the surplus. An example of where different proportions may be appropriate is where the surplus arose solely from insurance rebates. The actuary may consider that all the surplus could be equitably distributed to those members who were provided with insurance cover.

Where an allocation is being made in proportion to members' accounts, the allocation should usually be based on the account balances at the end of the fund's previous financial year.

Allocations of Miscellaneous Reserve amounts in other ways, such as to meet an employer's contribution liabilities, would be treated as ASAs in a similar manner to distributions from the Contributions Reserve.

6. MISCELLANEOUS**GROSSING UP FOR CONTRIBUTION TAX**

It should be noted that the Act does not include any provision which would gross up an ASA for the impact of contributions tax. Therefore no grossing up is required.

INTERIM ALLOCATIONS

Some funds allocate surplus on an interim basis when a member leaves the fund. This allocation could be as part of an interim interest rate or interim expense adjustment. The interim rates and adjustments are usually not varied when the final rates and adjustments for the year are determined.

The fact that different rates of surplus may have been applied to exiting and non-exiting members in a particular period does not require the Actuary to treat part or all of a surplus allocation (to either exiting or non-exiting members) as an ASA in circumstances where, if there had been no exits, the allocation would not have been treated as an ASA. However, the Actuary should be satisfied that the interim basis is consistent with the

trustee's general policy on interim calculations and is reasonable in the circumstances.

FUNDS WHICH DO NOT BALANCE ON 30 JUNE

For these funds, some surplus may have been allocated to members in the interim period between 30 June 1997 and the next annual review date (i.e. the date as at which the opening balances of the various reserves described in this Guidance Note were established).

In such cases, the actuary should apply the general principles set out in Section 2 to determine whether any allocations in the interim period should be treated as an ASA.

ACCUMULATION BENEFITS IN DEFINED BENEFIT FUNDS

“Accumulation only” and “accumulation add-on” benefits in defined benefit funds should, as far as possible, be treated in the same manner as benefits in accumulation funds. As at the first annual review date on or after 30 June 1997, opening balances of the three reserve accounts may be established.

For the Investment Reserve and the Contributions Reserve, these should be determined as described above for accumulation funds except that in the case of the Investment Reserve, the default limit is 15/85ths of the relevant accumulation balances (rather than the net market value of assets).

For subsequent credits to and from the Investment Reserve and the Contributions Reserve, the guidelines set out above for accumulation funds should be followed.

The Miscellaneous Reserve at any date should be determined by the Actuary as the balance of the assets (over and above amounts allocated to members' accounts, the Investment Reserve and the Contributions Reserve) which the Actuary considers are attributable to the relevant accumulation benefits.

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