CommonwealthBank GroupSuper

# Guide to tax free components of defined benefit pensions

The tables in this Guide provide general information about some of the features of tax free component calculations as they apply under taxation legislation since 1 July 2007 to the main defined benefit pensions in the various divisions of Commonwealth Bank Group Super.

A table of the relevant legislative provisions is on page 3. Some illustrative examples of calculations are included on pages 8–12 of this Guide.

The following assumptions apply to the information provided:

- the pensions are payable for the life of the member;
- upon death the pension may revert to the member's spouse;
- the pensions have not been purchased with rollover amounts (including any ETP or capital gains tax rollover amount or personal injury settlement paid into superannuation);
- no surcharge offset contributions have been made; and
- no child pension or allowance has been paid.

Note: Where these assumptions do not apply, the tax free component calculation method may differ from that shown in these tables.

### Important

This Guide has been prepared by Commonwealth Bank Officers Superannuation Corporation Pty Limited (ABN 76 074 519 798, AFSL 246418, RSEL L0003087) as trustee for Commonwealth Bank Group Super (ABN 24 248 426 878, RSER R1056877) based on its understanding of current regulatory requirements and laws as at 27 February 2012 (when the Guide was first issued). This Guide is not advice and is provided for general information only. It does not take into account your individual objectives, financial situation or needs. You should not rely on this information in making financial decisions. In particular, the calculation formulas set out in this Guide are summarised to provide an overview of the calculation principles. You should refer to the full text of the legislation for the full calculation method. For definitive advice on your personal financial situation you should consult your tax or financial adviser.

## Key points—pensioners aged 60 or over

- Once you reach age 60 (and in certain other circumstances) the whole of your pension payments from the fund are not assessable for income tax. However, the calculation of the tax free component that applies to your pension can still be relevant for some other purposes, including determination of social security and veterans' benefits.

## Key points—all pensioners

- The tax free component is calculated as a percentage of the annualised pension.
- The calculation methods that apply under the taxation legislation vary according to a number of factors, including (but not limited to):
  - the date on which the first pension payment is made;
  - whether the pension was in payment as at 1 July 2007 or payment commenced later;
  - if the pension was in payment as at 1 July 2007, whether the recipient was under age 60 or had reached age 60 at that time; and
  - whether any pre–July 1983 eligible service period applies, where this is included in the calculation method.
- The tax free component calculation cannot result in a tax free percentage less than zero.
- If you are a reversionary beneficiary in receipt of pension, your pension commencement date (for tax free component calculation purposes), is the date that the primary pension commenced.
- In each division where more than one type of superannuation benefit is payable, superannuation benefits payable as a lump sum, and those payable as a defined benefit pension, are treated as separate superannuation interests. This means that member contributions which are applied towards the lump sum superannuation benefit are not included in the member contributions applied to a defined benefit pension in that division, and separate tax free components for each interest may arise in that case. In the case of Division B, which has both an Indexed and Non-indexed pension, each of those pensions is also treated as a separate superannuation interest.
- Your pension commencement date may differ from the date the first pension payment is made. This can occur for a number of reasons, but generally arises where there may be a delay in you returning necessary documents, or where you take time to make choices between various benefit options that may be available within a particular division of the fund. In this situation, the first pension payment usually includes payment covering the period from the recorded pension commencement date. However, for tax free component calculation purposes, it is the date on which the first pension payment is made that is relevant to determine which calculation method applies under legislation.

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## Explanation of terms

Annual deductible amount – This is calculated as:

$$\frac{\text{UPP}}{\text{Life expectancy}}$$

where life expectancy is the life expectancy of the primary pensioner at commencement of the pension determined from Australian life tables (or, if the pension is reversionary and commenced on or after 1 July 1983, the longer of the two life expectancies).

The Annual deductible amount progressively reduces the Unused Undeducted Purchase Price of the pension.

Contributions segment – post-30 June 2007 member contributions in respect of a superannuation interest for which the member is not claiming a tax deduction.

Contributory pension – a pension to which member contributions are applied.

Crystallised ETP pension value – this is a notional ETP pension value determined as at the end of 30 June 2007 for pensions first paid after that date. The value is determined in accordance with rules in Regulation 307-205.01 of the ITAR 97 multiplied by age-based factors in Schedule 1B of those Regulations. The value is used to work out the Notional pre-July 83 component of the crystallised segment of the tax free component.

Crystallised segment – under Section 307-225 of the ITAA 97, this is calculated as at 30 June 2007 on the assumption that the entire value of the superannuation interest is paid out as an ETP at that time and, where there have not been any rollover amounts, is broadly, the sum of the Notional pre–July 83 component and Undeducted contributions as at 30 June 2007.

Eligible service period (ESP) – the period of employment and fund membership to which the particular superannuation interest relates. The period is determined in accordance with statutory rules (see former section 27A ITAA 36).

ETP – is short for eligible termination payment and has the meaning given under the provisions of the taxation legislation that apply, depending upon the first pension payment date.

ETP pension value – means the annualised pension value as at 30 June 2007 multiplied by the applicable age based factor under Schedule 1B of the ITAR 97.

ITAA 36 – refers to the Income Tax Assessment Act 1936.

ITAA 97 – refers to the Income Tax Assessment Act 1997.

ITAR 97 – refers to the Income Tax Assessment Regulations 1997.

ITTPA – refers to the Income Tax (Transitional Provisions) Act 1997.

Non-contributory pension – no member contributions are applied to this pension. This type of pension is fully funded by employer contributions. Therefore, no Annual deductible amount, no UPP (and no UUPP) apply.

Notional pre-July 83 component – this is a notional calculation carried out as at 30 June 2007 for pensions first paid after that date. The calculation is:

$$\frac{\left(\begin{array}{l}\text{Pre-July 83 ESP (number of days)} \\ \times \text{ Crystallised ETP pension value}\end{array}\right)}{\begin{array}{c}\text{Total ESP (number of days)} \\ \text{as at the end of 30 June 2007}\end{array}}$$

Pre-July 83 eligible service period (Pre-July 83 ESP) – means the pre-July 83 service under former section 27A of the ITAA 36.

If your first pension payment from the fund was on or after 1 July 1994 and before 1 July 2007 and you were aged **60 or over** at that date this is calculated as:

$$\frac{\text{Pre-July 83 ESP (number of days)}}{\begin{array}{c}\text{Total ESP as at the end of} \\ \text{30 June 2007 (number of days)}\end{array}}$$

If your first pension payment from the fund was on or after 1 July 1994 and before 1 July 2007 and you were aged **under 60** at that date, this is calculated as:

$$\frac{\text{Pre-July 83 ESP (number of days)}}{\begin{array}{c}\text{Total ESP as at the end of the day prior to the} \\ \text{trigger event (number of days)}\end{array}}$$

*Note: The legislation does not include any Pre-July 83 ESP in the tax free component calculation for pensions that commenced before 1 July 1994.*

Primary pensioner – the person who becomes entitled to a defined benefit pension under the rules of the fund upon retirement from employment or incapacity (or the death in service of a member of the fund).

Reversionary beneficiary – a person who becomes entitled to receive pension payments under the rules of the fund, upon death of the primary pensioner.

Surcharge offset contributions – refers to voluntary member contributions made to offset the imposition of surcharge, where applicable. Superannuation surcharge applies to certain superannuation contributions made, or eligible termination payments received between 20 August 1996 and 30 June 2005.

TFC – is short for tax free component. The tax free component is calculated in accordance with legislation. The Table of Legislation on page 3 lists the main relevant provisions.

Total pension value – means the annual pension value at the date the pension commences multiplied by the applicable age based factor under Schedule 1B of the ITAR 97.

Trigger ETP pension value – where at least one pension payment had been made by the end of 30 June 2007, this is determined in accordance with rules in Regulation 307-205.02 of the ITAR 97. The annualised pension at the end of the day before the trigger event is multiplied by the applicable age-based factor in Schedule 1B of those Regulations.

Trigger event – is an event referred to in section 307-125(3) of the ITTPA, being the first to occur of:

- turning age 60 (or the end of 30 June 2007 if the pensioner was already aged 60),
- death; or
- commutation or partial commutation of the pension.

Undeducted contributions – has the meaning given in section 27A ITAA 36 and broadly refers to member contributions for which no taxation deduction has previously been claimed.

UPP is short for Undeducted Purchase Price and has the meaning given under the provisions of the taxation legislation that apply, depending upon the first pension payment date.

UUPP is short for Unused Undeducted Purchase Price and means the Undeducted Purchase Price less, broadly expressed, the Annual deductible amount already used up. If you were aged 60 or over on 1 July 2007, this is calculated as at 30 June 2007. If you were aged under 60 as at 1 July 2007, this is calculated as at the end of the day prior to the trigger event.

Generally, if the pension has been in payment for longer than the relevant life expectancy at the applicable calculation date (see above), there would be no UUPP.

## Table of Legislation

| First Pension payment date | Legislation prior to 1 July 2007 | Legislation from 1 July 2007, if aged 60 or over at 1 July 2007 | Legislation from 1 July 2007, if aged under 60 at 1 July 2007 |
|---|---|---|---|
| Before 1 July 1983 | Section 26AA ITAA 36 | Section 307-125(6A) and (6)(b) of the ITTPA apply | An approach based on section 27H of the ITAA 36 applies in accordance with s.307-125(2) of the ITTPA until a trigger event, then section 307-125(6)(b) of the ITTPA applies |
| 1 July 1983 – 30 June 1994 | Section 27H ITAA 36 | *As above* | *As above* |
| 1 July 1994 – 30 June 2007 | Section 27H ITAA 36 | Section 307-125(6) of the ITTPA | An approach based on section 27H of the ITAA 36 applies in accordance with s.307-125(2) of the ITTPA until a trigger event, then section 307-125(6) of the ITTPA applies |
| On or after 1 July 2007 | n/a | Section 307-125 ITAA 97 | Section 307-125 ITAA 97 |

# Tables of calculation methods that apply from 1 July 2007

## Table 1: Pension payment commencing before 1 July 1983

| Division | Defined Benefit Pension type | Column 1: Primary pensioner age 60 or over at 1 July 2007 | Column 2: Primary pensioner under age 60 at 1 July 2007 |
|---|---|---|---|
| B | Indexed Pension, Retirement or Invalidity | Non-contributory pension<br>No UUPP applies<br>No Pre–July 83 ESP included<br>No TFC applies<br>*See Example 1 at page 8* | Non-contributory pension<br>**Before trigger event**:<br>No Annual deductible amount applies<br><br>**On trigger event:**<br>No UUPP applies and<br>No Pre–July 83 ESP included<br>No TFC applies |
| B<br><br>C<br><br>D<br><br>E<br><br>CF<br><br>CH | Non-Indexed Additional pension<br><br>Retirement or Invalidity<br><br>Retirement or Invalidity<br><br>Invalidity<br><br>Retirement or Invalidity<br><br>Retirement | Contributory pension<br>$TFC = \frac{UUPP}{ETP\ pension\ value} \times 100\%$<br><br>No Pre–July 83 ESP included<br>Note: Generally, the TFC will be zero if the pension has been in payment longer than the life expectancy as at 30 June 2007 | Contributory pension<br>**Before a trigger event**:<br>TFC = Annual deductible amount as at 30 June 2007<br><br>**On trigger event**:<br>$TFC = \frac{UUPP}{Trigger\ ETP\ pension\ value} \times 100\%$<br><br>No Pre–July 83 ESP included<br>Note: Generally, the TFC will be zero if the pension has been in payment longer than the life expectancy as at the day prior to trigger event |
| CK | | Non-contributory pension<br>*See above* | Non-contributory pension<br>*See above* |
| CO (Part A) | Retirement or Invalidity | Contributory pension<br>*See above* | Contributory pension<br>*See above* |

## Table 2: Pension payment commencing after 30 June 1983 and before 1 July 1994

| Division | Defined Benefit Pension type | Column 1: Primary pensioner aged 60 or over at 1 July 2007 | Column 2: Primary pensioner under age 60 at 1 July 2007 |
|---|---|---|---|
| **B** | Indexed Pension, Retirement or Invalidity | Non-contributory pension<br>No UUPP applies<br>No Pre–July 83 ESP included<br>No TFC applies<br>*See Example 2 at page 8* | Non-contributory pension<br>**Before trigger event:**<br>No Annual deductible amount applies<br><br>**On trigger event:**<br>No UUPP applies and<br>No Pre-July 83 ESP included<br>No TFC applies |
| **B** | Non-Indexed Additional pension | Contributory pension<br>$TFC = \frac{UUPP}{ETP\ pension\ value} \times 100\%$<br><br>No Pre–July 83 ESP included<br>*See Example 2 at page 8*<br>Note: Generally, the TFC will be zero if the pension has been in payment longer than the life expectancy as at 30 June 2007 | Contributory pension<br>**Before a trigger event**:<br>TFC = Annual deductible amount as at 30 June 2007<br><br>**On trigger event**:<br>$TFC = \frac{UUPP}{Trigger\ ETP\ pension\ value} \times 100\%$<br><br>No Pre–July 83 ESP included<br>Note: Generally, the TFC will be zero if the pension has been in payment longer than the life expectancy as at the day prior to trigger event |
| **C** | Retirement or Invalidity | | |
| **D** | Retirement or Invalidity | | |
| **E** | Invalidity | | |
| **CF** | Retirement or Invalidity | | |
| **CH** | Retirement | | |
| **CK** | Retirement or Invalidity | Non-contributory pension<br>*See above* | Non-contributory pension<br>*See above* |
| **CO (Part A)** | Retirement or Invalidity | Contributory pension<br>*See above* | Contributory pension<br>*See above* |

## Table 3: Pension payment commencing after 30 June 1994 and before 1 July 2007

| Division | Defined Benefit Pension type | Column 1: Primary pensioner aged 60 or over at 1 July 2007 | Column 2: Primary pensioner under age 60 at 1 July 2007 |
|---|---|---|---|
| **B** | Indexed Pension, Retirement or Invalidity | Non-contributory pension<br>No UUPP applies<br>$$TFC = \frac{\left(\text{ETP pension value} \times \text{Pre-July 83 ESP}\right)}{\text{ETP pension value}} \times 100\%$$<br>If there is no applicable Pre-July 83 ESP, the percentage will be nil | Non-contributory pension<br>**Before a trigger event:**<br>No Annual deductible amount applies<br>No TFC until trigger event<br>**On trigger event:**<br>No UUPP applies<br>$$TFC = \frac{\left(\text{Trigger ETP pension value} \times \text{Pre-July 83 ESP}\right)}{\text{Trigger ETP pension value}} \times 100\%$$<br>*See Example 4 at page 9*<br>If there is no applicable Pre-July 83 ESP, the percentage will be nil |
| **B**<br>**C**<br>**D**<br>**E**<br>**CF**<br>**CH** | Non-Indexed Additional pension<br>Retirement or Invalidity<br>Retirement or Invalidity<br>Invalidity<br>Retirement or Invalidity<br>Retirement | Contributory pension<br>$$TFC = \frac{\left[\text{UUPP} + (\text{ETP pension value} \times \text{Pre-July 83 ESP})\right]}{\text{ETP pension value}} \times 100\%$$<br>*See Example 3 at page 9* | Contributory pension<br>**Before a trigger event:**<br>TFC = Annual deductible amount as at 30 June 2007<br>**On trigger event:**<br>$$TFC = \frac{\left[\text{UUPP} + (\text{Trigger ETP pension value} \times \text{Pre-July 83 ESP})\right]}{\text{Trigger ETP pension value}} \times 100\%$$<br>*See Examples 4 and 5 at pages 9–10* |
| **CK** | Retirement or Invalidity | Non-contributory pension<br>*See above* | Non-contributory pension<br>*See above* |
| **CO (Part A)** | Retirement or Invalidity | Contributory pension<br>*See above* | Contributory pension<br>*See above* |

## Table 4: Pension payment commencing after 30 June 2007

| Division | Defined Benefit Pension type | Section 307-125 of the Income Tax Assessment Act 1997 applies |
|---|---|---|
| **B** | Indexed Pension, Retirement or Invalidity | Non-contributory pension<br>The TFC comprises the sum of:<br>(a) the crystallised segment – as no undeducted contributions apply to this kind of pension, this is equal to the Notional pre-July 83 component only (if any); and<br>(b) the contributions segment (this is nil for this kind of pension).<br>On pension commencement:<br>$\text{TFC} = \frac{\text{Crystallised segment} + (0)}{\text{Total pension value}} \times 100\%$<br>This TFC percentage is then applied to each pension payment<br>*See Example 6 at page 11* |
| **B** | Non-Indexed Additional Pension | Contributory pension<br>*See below as for Divisions D and following*<br>*See Example 6 at page 11* |
| **C** | Retirement or Invalidity | Contributory pension<br>In this division, a minimum of 50% of the lump sum benefit may be taken as a pension. The crystallised segment is calculated on the basis that the entire benefit is taken as a pension[1]. The TFC percentage is determined having regard to the total value of the benefit taken and then applied to both the benefit taken as a pension (if any) and the benefit that is taken as a lump sum (if any).<br>*See Example 7 at page 12*<br>$\text{TFC} = \frac{\text{Crystallised segment} + \text{Contributions segment}}{\text{Total pension value} + \text{lump sum value as applicable}} \times 100\%$ |
| **D**<br>**E**<br>**CF**<br>**CH** | Retirement or Invalidity<br>Invalidity<br>Retirement or Invalidity<br>Retirement | Contributory pension<br>$\text{TFC} = \frac{\text{Crystallised segment} + \text{Contributions segment}}{\text{Total pension value}} \times 100\%$<br>*See Example 8 at page 12* |
| **CK** | Retirement or Invalidity | Non-contributory pension<br>*See above as for Division B indexed pension* |
| **CO (Part A)** | Retirement or Invalidity | Contributory pension<br>*See above as for Divisions D and following* |

1 See Regulation 307-125.01 of the ITAR 97

# Illustrative examples of tax free component calculations for Defined Benefit pensions that apply from 1 July 2007

**IMPORTANT: The examples below are hypothetical and are prepared for illustration purposes only. Individual circumstances may vary from the examples shown. In these examples, the pension commencement date and the date on which the first pension payment is made are assumed to be the same date.**

## EXAMPLE 1: Division B Indexed pension only, commenced payment before 1 July 1994, pension recipient aged 60 or over at 1 July 2007

John is a Division B member and commenced an Indexed pension from that division on 25 February 1983.

**Tax free component calculation as at 30 June 2007 trigger event**

John's date of birth is 5 November 1921. Therefore his age at 30 June 2007 was 85. Being aged 60 or greater at that date means the tax free component calculation for the pension is performed as at the end of 30 June 2007.

The pension is a non-contributory pension. Therefore there is no unused undeducted purchase price.

John's eligible service period commenced in 1938. Nevertheless, a tax free pre-July 83 ESP is not included because the pension commenced payment before 1 July 1994.

There is no tax free component to apply for the Indexed pension following the trigger event.

## EXAMPLE 2: Division B Indexed pension and Non-indexed pension, commenced payment before 1 July 1994, pension recipient aged 60 or over at 1 July 2007

Robert is a Division B member and commenced both an Indexed pension and Non-indexed pension from that division on 2 July 1988 at age 55. (His date of birth is 1 July 1933.)

**Tax free component calculation as at 30 June 2007 trigger event**

At 30 June 2007, Robert had already reached age 60 (he was aged 73). Therefore the tax free component calculation needs to be performed as at the end of that day.

*Indexed pension*

The pension is a non-contributory pension. Therefore there is no unused undeducted purchase price.

Robert's eligible service period commenced in 1975. Nevertheless, a tax free pre-July 83 ESP is not included because the pension commenced payment before 1 July 1994.

There is no tax free component for the Indexed pension.

*Non-indexed pension*

The Non-indexed pension is a contributory pension.

The undeducted purchase price of the Non-indexed pension was **$4,880.48**. At the time the pension commenced, his life expectancy determined in accordance with the applicable Australian Life Tables was 21.02 years, and the life expectancy of his reversionary spouse (younger spouse) was 31.61 years. The longer of the two life expectancies (31.61) is used in the calculation of the annual deductible amount.

The annual deductible amount for the Non-indexed pension was therefore:

$$\frac{\text{UPP}}{\text{life expectancy}} = \frac{\$4{,}880.48}{31.61} = \mathbf{\$154.40}$$

To work out the unused undeducted purchase price, work out the undeducted purchase price less the annual deductible amount that has been 'used up' by being returned to Robert tax free in the pension payments up until 30 June 2007. This will be the annual deductible amount multiplied by the time period from pension commencement until the end of 30 June 2007. A period of almost 19 years elapsed over that time, during which $2,933.18 of the annual deductible amount has therefore been 'used up'. The remaining unused undeducted purchase price at as at the end of 30 June 2007 was therefore $4,880.48 – $2,933.18 = **$1,947.30**.

As mentioned, a tax free pre-July 83 ESP is not included for pensions where payment commenced before 1 July 1994.

As at the end of 30 June 2007, the annual Non-indexed pension payments are $650.

This annual pension is multiplied by 9.756, being the age-based factor drawn from Schedule 1B of the ITAR 97 for his then age of 73, to give an ETP pension value of $6,341.40.

(Note that the Schedule 1B factors are determined on the basis of the of the age of the pension recipient at the end of 30 June 2007, without taking into account the age of the reversionary spouse who may in the future receive the pension.)

The tax free component of the Non-indexed pension is:

$$\frac{\text{UUPP}}{\text{ETP pension value}} \times 100\%$$

$$= \frac{\$1{,}947.30}{\$6{,}341.40} = 30.71\%$$

The tax free component is applied to payments of the Non-indexed pension from the time of the trigger event. There is no tax free component for the Indexed pension.

### EXAMPLE 3: Division C indexed pension, commenced payment after 30 June 1994 and before 1 July 2007, pension recipient aged 60 or over at 1 July 2007

Christine is a Division C member and commenced an indexed pension from that division on 16 February 2007 at age 64. (Her date of birth is 8 January 1943.)

**Tax free component calculation as at 30 June 2007 trigger event**

At 30 June 2007, Christine had already reached age 60 (she is aged 64). Therefore the tax free component calculation needs to be performed as at the end of that day.

The undeducted purchase price of the pension was **$42,612.81**. At the time the pension commenced, her life expectancy determined in accordance with the applicable Australian Life Tables was 22.25 years.

The annual deductible amount for the pension was therefore:

$$\frac{\text{UPP}}{\text{life expectancy}} = \frac{\$42{,}612.81}{22.25} = \mathbf{\$1{,}915.18}$$

Christine's life expectancy is used in the calculation because it is longer than her reversionary spouse. (If her reversionary spouse's life expectancy had been longer, it should have been used instead.)

To work out the unused undeducted purchase price, work out the undeducted purchase price less the annual deductible amount that has been 'used up' by being returned to Christine tax free in the pension payments until the end of 30 June 2007. This will be the annual deductible amount multiplied by the time period from pension commencement until the end of 30 June 2007. A period of almost 4½ months elapsed over that time, during which $703.11 of the annual deductible amount will have been 'used up'. The remaining unused undeducted purchase price as at the end of 30 June 2007 was $42,612.81 – $703.11 = **$41,909.70**.

Christine's eligible service period commenced on 15 July 1976. This is a total eligible service period of 11,307 days through to the end of 30 June 2007, of which 2,541 days were pre-1 July 1983. The pre-July 83 ESP is therefore 2,541 ÷ 11,307 = **22.473%**.

As at the end of 30 June 2007, the annual indexed pension payments are $14,200. This annual pension is multiplied by 15.213, being the age-based factor drawn from Schedule 1B of the ITAR 97 for her then age (which was still 64 since she had not yet had another birthday since the pension commenced), to give an ETP pension value of $216,024.60.

(Note that the Schedule 1B factor is different to the life expectancy drawn from the Australian Life Tables.)

The tax free component is:

$$\frac{\text{UUPP} + (\text{ETP pension value} \times \text{Pre-July 83 ESP})}{\text{ETP pension value}} \times 100\%$$

$$= \frac{\$41{,}909.70 + (\$216{,}024.60 \times 22.473\%)}{\$216{,}024.60} \times 100\%$$

$$= \mathbf{41.87\%}$$

The tax free component is applied to pension payments from the time of the trigger event.

### EXAMPLE 4: Division B Indexed pension and Non-indexed pension, commenced payment after 30 June 1994 and before 1 July 2007, pension recipient aged *under* 60 at 1 July 2007, noting the change in the tax treatment on the trigger event

David is a Division B member and commenced both an Indexed pension and Non-indexed pension from that division on 30 March 2003 at age 55. (His date of birth is 28 March 1948.)

**Annual deductible amount from pension commencement to trigger event**

*Indexed pension*

The Indexed pension is a non-contributory pension and therefore did not have any undeducted purchase price or annual deductible amount.

*Non-indexed pension*

The Non-indexed pension is a contributory pension. The undeducted purchase price of the pension was **$27,914.65**. At the time the pension commenced, his life expectancy determined in accordance with the applicable Australian Life Tables was 25.41 years, and the life expectancy of his reversionary spouse was 32.25 years. The longer of the two life expectancies (32.25) is used in the calculation of the annual deductible amount.

The annual deductible amount for the pension was therefore:

$$\frac{\text{UPP}}{\text{life expectancy}} = \frac{\$27{,}914.65}{32.25} = \mathbf{\$865.57}$$

This annual amount is the tax free component up until the trigger event.

**Tax free component calculation on trigger event**

David reached age 60 on 28 March 2008. He had not commuted any portion of his pensions since 1 July 2007. Therefore turning age 60 is the trigger event. The trigger event calculations need to be performed just before that day (ie when he was still aged 59).

*Indexed pension*

The Indexed pension is a non-contributory pension and therefore did not have any undeducted purchase price or annual deductible amount.

The trigger event calculation requires calculation of the pre-July 83 ESP.

David's eligible service period commenced on 12 January 1965. This is a total eligible service period of 15,780 days through to just before the trigger event (ie through to 27 March 2008), of which 6,743 days were pre-1 July 1983. The pre-July 83 ESP is therefore 6,743 ÷ 15,780 = **42.731%**.

Just before the trigger event, the annual Indexed pension payments are $19,700. This annual pension is multiplied by 16.810, being the age-based factor drawn from Schedule 1B of the ITAR 97 for an indexed pension for age 59 (which was David's age just before the trigger event), to give a trigger ETP pension value of $331,157.

The tax free component is:

$$\frac{\text{UUPP} + (\text{Trigger ETP pension value} \times \text{Pre-July 83 ESP})}{\text{Trigger ETP pension value}} \times 100\%$$

$$= \frac{\$0 + (\$331{,}157 \times 42.731\%)}{\$331{,}157} \times 100\%$$

$$= \mathbf{42.731\%}$$

The tax free component is applied to Indexed pension payments from the time of the trigger event.

*Non-indexed pension*

The Non-indexed pension is a contributory pension. A period of approximately 5 years elapsed from the commencement of the pension through to the trigger event. During that time $4,314.48 of the undeducted purchase price will have been 'used up' by being returned to David tax free in the pension payments[2].

The remaining unused undeducted purchase price at as at the end of 30 June 2007 was $27,914.65 – $4,314.48 = **$23,600.17**.

As calculated above, the pre-July 83 ESP is **42.731%**.

Just before the trigger event, the annual Non-indexed pension payments are $18,900. This annual pension is multiplied by 12.790, being the age-based factor drawn from Schedule 1B of the ITAR 97 for a non-indexed pension for age 59 (which was David's age just before the trigger event), to give a trigger ETP pension value of $241,731.

The tax free component is:

$$\frac{\text{UUPP} + (\text{Trigger ETP pension value} \times \text{Pre-July 83 ESP})}{\text{Trigger ETP pension value}} \times 100\%$$

$$= \frac{\$23{,}600.17 + (\$241{,}731 \times 42.731\%)}{\$241{,}731} \times 100\%$$

$$= \mathbf{52.49\%}$$

The tax free component is applied to Non-indexed pension payments from the time of the trigger event.

The Indexed pension and Non Indexed pension are separate interests and have separate tax free components applied.

**EXAMPLE 5: Division C indexed pension, commenced payment after 30 June 1994 and before 1 July 2007, pension recipient aged *under* 60 at 1 July 2007, noting the change in the tax treatment on the trigger event**

Julie is a Division C member and commenced an Indexed pension from that division on 11 February 2005 at age 55. (Her date of birth is 7 August 1949.)

**Annual deductible amount from pension commencement to trigger event**

The undeducted purchase price of the pension was **$16,245.26**. At the time the pension commenced, her life expectancy determined in accordance with the applicable Australian Life Tables was 29.80 years, and the life expectancy of her reversionary spouse was 26.77 years. The longer of the two life expectancies (29.80) is used in the calculation of the annual deductible amount.

The annual deductible amount for the pension was therefore:

$$\frac{\text{UPP}}{\text{life expectancy}} = \frac{\$16{,}245.26}{29.80} = \mathbf{\$545.14}$$

This annual amount is the tax free component up until the trigger event.

**Tax free component calculation on trigger event**

Julie reached age 60 on 7 August 2009. She had not commuted any portion of her pension since 1 July 2007 therefore turning age 60 is the trigger event. The trigger event calculation needs to be performed just before that day (ie when she was still aged 59).

A period of approximately 4½ years elapsed from the commencement of the pension through to the trigger event. During that time $2,446.42 of the undeducted purchase price will have been 'used up' by being returned to Julie tax free in the pension payments[2].

The remaining unused undeducted purchase price as at

2 This is calculated as the annual deductible amount multiplied by the time period between pension commencement and the trigger event.

the end of 30 June 2007 was \$16,245.26 – \$2,446.42 = **\$13,798.84**.

Julie's eligible service period commenced after 1 July 1983. Therefore her pre-July 83 ESP is **0%**.

Just before the trigger event, the annual pension payments are \$5,780. This annual pension is multiplied by 16.810, being the age-based factor drawn from Schedule 1B of the ITAR 97 for an indexed pension for age 59 (which was Julie's age just before the trigger event), to give a trigger ETP pension value of **\$97,161.80**.

The tax free component is:

$$\frac{\text{UUPP} + (\text{Trigger ETP pension value} \times \text{Pre-July 83 ESP})}{\text{Trigger ETP pension value}} \times 100\%$$

$$= \frac{\$13{,}798.84 + (\$97{,}161.80 \times 0\%)}{\$97{,}161.80} \times 100\%$$

$$= \mathbf{14.20\%}$$

The tax free component is applied to pension payments from the time of the trigger event.

## EXAMPLE 6: Division B Indexed pension and Non-indexed additional pension, commenced payment after 30 June 2007

Jennifer is a Division B member and is entitled to both an Indexed pension and Non-indexed pension from that division. Neither pension has commenced to be paid at 30 June 2007.

**Calculation of crystallised segment**

Jennifer's date of birth is 27 January 1948. Therefore her age at 30 June 2007 was 59. Her eligible service period commenced on 3 July 1986.

*Indexed pension*

There is no pre-July 83 ESP. Therefore the notional pre-July 83 component is **\$0**.

The pension is a non-contributory pension and therefore does not have any undeducted purchase price.

The crystallised segment is the sum of these two components. Therefore, the crystallised segment is **\$0**.

*Non-indexed pension*

There is no pre-July 83 ESP. Therefore the notional pre-July 83 component is **\$0**.

The Non-indexed pension is a contributory pension. The fund trustee has calculated that undeducted contributions to 30 June 2007 are **\$14,898.58**.

The crystallised segment is the sum of these two components. Therefore, the crystallised segment is \$0 + \$14,898.58 = **\$14,898.58**.

**Pension commencement**

Jennifer commenced both her pensions on 31 July 2010 at age 62.

*Indexed pension*

The pension is a non-contributory pension and therefore the contributions segment = **\$0**.

The tax free component for this pension is:

$$\frac{\text{crystallised segment } (\$0) + \text{contributions segment } (\$0)}{\text{Total pension value}} \times 100\%$$

In the absence of any crystallised segment or contributions segment, it is not necessary to value this pension in order to determine that the tax free component is **0%**.

*Non-indexed pension*

There have been further undeducted contributions made in respect of the Non-indexed pension since 30 June 2007 of \$3,091.19. Therefore the contributions segment is **\$3,091.19**.

The Non-indexed pension is \$4,200 per annum. This annual pension is multiplied by 12.287, being the age-based factor drawn from Schedule 1B of the ITAR 97 for age 62 for a Non-indexed pension, to give a total pension value of **\$51,605.40**.

The tax free component for this pension is:

$$\frac{\text{crystallised segment} + \text{contributions segment}}{\text{Total pension value}} \times 100\%$$

$$= \frac{\$14{,}898.58 + \$3{,}091.19}{\$51{,}605.40} \times 100\%$$

$$= \mathbf{34.86\%}$$

The tax free component is applied to each Non-indexed pension payment after pension commencement. There is no tax free component for the Indexed pension.

### EXAMPLE 7: Division C indexed pension, commenced payment after 30 June 2007, benefit drawn split between a pension and commutation lump sum

Susan is a Division C member and is entitled to a lump sum benefit from that division upon retirement. In this division a minimum of 50% of the benefit may be taken as an indexed pension. The crystallised ETP pension value is calculated as at 30 June 2007 as if the whole benefit is taken at that date as a pension[3]. Susan has not retired as at 30 June 2007.

**Calculation of crystallised segment**

Susan's date of birth is 15 February 1949. Therefore her age at 30 June 2007 was 58.

Her eligible service period commenced on 5 July 1991. Therefore there is no pre-July 83 ESP, and the notional pre-July 83 component will be **$0**.

The fund trustee has calculated that the undeducted contributions were **$25,563.25** at 30 June 2007.

The crystallised segment is the sum of these two components. Therefore, the crystallised segment is $0 + $25,563.25 = **$25,563.25**.

**Pension commencement**

Susan retired on 18 February 2010 at age 61, and decided to take her benefit in part as an indexed pension, with the balance of her benefit drawn as a lump sum commutation of $73,900.

There had been further undeducted contributions made in respect of the pension interest since 30 June 2007 of $4,192.30. Therefore the contributions segment is **$4,192.30**.

The indexed pension is $5,500 per annum. This annual pension is multiplied by 16.209, being the age-based factor drawn from Schedule 1B of the ITAR 97 for age 61 for an indexed pension, to give a total pension value of **$89,149.50**.

The tax free component is:

$$\frac{\text{crystallised segment} + \text{contributions segment}}{\text{Total pension value} + \text{lump sum value}} \times 100\%$$

$$= \frac{\$25,563.25 + \$4,192.30}{\$89,149.50 + \$73,900} \times 100\%$$

$= \mathbf{18.25\%}$

The tax free component is applied to both the lump sum benefit and to each pension payment.

### EXAMPLE 8: Division CF indexed pension, commenced payment after 30 June 2007

Peter is a Division CF member and is entitled to an indexed pension from that division. The pension has not commenced to be paid at 30 June 2007.

**Calculation of crystallised segment**

Peter's date of birth is 25 April 1954. Therefore his age at 30 June 2007 was 53. His eligible service period commenced on 1 December 1969. This is a total eligible service period of 13,726 days through to the end of 30 June 2007, of which 4,960 days were pre-July 83 ESP.

The crystallised ETP pension value is calculated in accordance with statutory rules[3] as if the benefit was drawn at the end of 30 June 2007. The fund trustee calculates the notional pension value as $34,060 per annum. This pension value is multiplied by 17.927, being the age-based factor drawn from Schedule 1B of the ITAR 97 for age 55 for an indexed pension, to give a crystallised ETP pension value of **$610,593.62**. Note that rules in the ITAR 97 require the age-based factor for age 55 to be used where the member is younger than that.

The notional pre-July 83 component is:

$$\frac{\text{pre-July 83 ESP} \times \text{crystallised ETP pension value}}{\text{total ESP days}}$$

$$= \frac{4,960 \text{ days} \times \$610,593.62}{13,726 \text{ days}} = \mathbf{\$220,642.89}$$

The fund trustee has calculated that the undeducted contributions for the pension were **$14,753.40** at 30 June 2007. The crystallised segment is the sum of these two components. In total therefore it is $220,642.89 + $14,753.40 = **$235,396.29**.

**Pension commencement**

Peter commenced his pension on 28 April 2010 at age 56. There have been further undeducted contributions made in respect of the pension interest since 30 June 2007 of $8,842. Therefore the contributions segment is **$8,842**.

The indexed pension is $45,310 per annum. This annual pension is multiplied by 17.659, being the age-based factor drawn from Schedule 1B of the ITAR 97 for age 56 for an indexed pension, to give a total pension value of **$800,129.29**.

The tax free component is:

$$\frac{\text{crystallised segment} + \text{contributions segment}}{\text{Total pension value}} \times 100\%$$

$$= \frac{\$235,396.29 + \$8,842}{\$800,129.29} \times 100\% = \mathbf{30.52\%}$$

3 See Regulation 307-125.01 of ITAR 97