TS Issue 35
January 2016

Technically Speaking…

Superannuation interests, the proportioning rule and rounding.

The components of a superannuation benefit which are set out in Subdivision 307-C of the Income Tax Assessment Act 1997 consist of a tax free and taxable component. These components are determined each time a lump sum is paid or at the commencement of an income stream.

As a general rule the taxable component is calculated after the amount standing to a person's superannuation interest or interests in accumulation phase has been reduced by the tax free component. However, adjustments are made to these components in the case of disability benefits and payments containing an untaxed element such as certain death benefit payments. A superannuation interest is defined in Subdivision 307-D of the Act and the Income Tax Assessment Regulations 1997. A person has one superannuation interest except where they have a pension and each pension is a separate superannuation interest and therefore has a taxable and tax free component in its own right.

Some payments are deemed as consisting wholly of a taxable or tax free component, for example, superannuation guarantee payments and spouse contribution splitting amounts are deemed to be a wholly taxable component while the co-contribution is deemed to be a wholly tax free component.

When paying a lump sum from the fund, with the exception of the full or partial commutation of an income stream, the proportioning rule is used to determine the taxable and tax free components as a percentage of the total amount standing to the member's credit in accumulation phase. If a pension is being commenced the taxable and tax free components are determined at that time in the same way as they are for a lump sum. That proportion remains with the pension until it ceases and the same proportion also applies to any lump sum commutation made from the pension.

While the income tax legislation provides rules in relation to a person's superannuation interest and how to calculate the taxable and tax free components it does not include the finer points of rounding the percentage of the relevant components. The best we can do in this regard is the procedure adopted for rounding by the ATO in its calculator which works out the taxable and tax free amounts for purposes of the proportioning rule.

The ATO's procedure for calculating the proportioning rule does not round down the decimal places for the taxable and tax free amounts. However, when calculating the tax free percentage the ATO's calculator truncates the result to 5 decimal places which are rounded up to 4 decimal places to the nearest whole number if the 5th decimal place is 5 or greater and if it is less than 5 it is rounded down to the lower whole number.

In working out the taxable proportion of the benefit as a percentage, the non-taxable percentage rounded to 4 decimal places is deducted from 100%.
Here are some examples of how the percentage is determined:

Calculated percentage (tax free component)	**Determined percentage (rounded) (tax free component)**	**Determined percentage (taxable component)**
46.25332%	46.2533%	53.7467%
46.25375%	46.2538%	53.7462%
46.25388%	46.2539%	53.7461%
46.1%	46.1000%	53.9000%

The next step in the process is calculating the dollar amount of the tax free and taxable components of the proportions. The amounts as calculated by the ATO are rounded to 3 decimal places and then that amount is rounded to 2 decimal places based on the value of the third decimal number. In a similar way, the same procedure is used in calculating the percentage of the tax free proportion. If the third decimal number is 5 or greater the second decimal point is rounded up to the next whole number. If it is less than 5 it is rounded down to the lower whole number.

Here are some examples of how the amount is determined:

Calculated Amount	Determined amount (rounded)
49,000.372	$49,000.37
49,000.375	$49,000.38
49,000.378	$49,000.38

Case Study

Maureen has decided to retire and has a superannuation balance of $750,000 in her self-managed superannuation fund. She has decided to receive a lump sum of $60,000 to pay some debts and with the remainder of $690,000 commence an account based pension. The tax free component of the accumulation superannuation interest is $250,000.

Tax free amount of the lump sum

The lump sum has been drawn from the fund first and the proportions as a percentage of the total benefit would be calculated as:

$$\$250{,}000 \div \$750{,}000 = 33.33333\%$$

The percentage would be rounded down at the 4th decimal place to the lower whole number of 33.3332% for the tax free component. The taxable component would then be:

$$100\% - 33.3332\% = 66.6668\%$$

The tax free amount of the lump sum would then be calculated as:

$$\$60{,}000 \times 33.3332\% = \$19{,}999.92$$

As this amount does not result in 3 decimal points there is no need to round the 3rd decimal point which is 0.

The taxable amount of the lump sum would be $60,000.00 - $19,999.92 = $40,000.08

Tax free amount of the income stream

Calculation of the tax free amount of the income stream which commences after the payment of the lump sum would be:

$$\$230{,}000.08 \div \$690{,}000 = 33.33333$$

The percentage would be rounded down at the 4th decimal place to the lower whole number of 33.3332% for the tax free component. The taxable component would then be:

$$100\% - 33.3332\% = 66.6668\%$$

The tax free amount of the lump sum would then be calculated as:

$$\$690{,}000 \times 33.3332\% = \$229{,}999.08$$

As this amount does not result in 3 decimal points there is no need to round the 3rd decimal point which is 0.

The taxable amount of the lump sum would be $690,000.00 - $229,999.08 = $460,000.92

Record Keeping

It is necessary to retain the proportions of the taxable and tax free components for an income stream until it ceases. The main reasons are for the payment of death benefits if it is paid to a non-dependant child (basically a child older than 18), where the income stream may be commuted and rolled over to another fund, or returned back to accumulation phase and used to commence another income stream or pay a lump sum in future. This would be required irrespective of whether the relevant member or their dependant, as defined for purposes of the Superannuation Industry (Supervision) Act 1994, is aged 60 or over or younger than age 60.