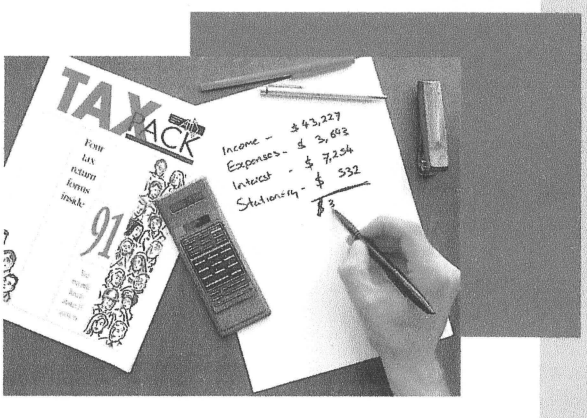
DFRDB Defence Force Retirement & Death Benefits

Taxation



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Retirement Benefits Office RBO

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This leaflet is a guide to the taxation provisions that apply to the Defence Force Retirement and Death Benefits (DFRDB) scheme. In the event of any discrepancy between this leaflet and the Defence Force Retirement and Death Benefits Act, 1973, or the Income Tax Assessment Act, 1936, the legislation will prevail.

Introduction

1 Since 1 July 1983 the Federal Government has introduced significant changes to both the taxation system and the superannuation industry. These changes, combined with the changes to the government superannuation schemes, produce a complex set of rules which affect your entitlements. This leaflet will try to simply explain some of the more important rules which will affect you.

Some tax terms you should know

2 Whenever you receive a benefit from a superannuation scheme, you will also receive important information for tax purposes. With this information you will need to make decisions which can have significant tax implications. In some cases you may need to seek help from professionals. A knowledge of some of the terms you're likely to come across could be very useful in helping you make an informed decision. For these reasons this leaflet gives some simple definitions of the most common tax terms in superannuation.

Eligible Service Period (ESP)

3 This is the period of service used to calculate which amounts of your benefit should be taxed and at what rates. The Retirement Benefits Office (RBO) will only deduct tax from the post '83 component (see paragraphs 10 to 13). Generally, the ESP will be the length of service from the date you started in the Australian Defence Force and the date your benefit is paid. In some cases, earlier periods of service can give you a longer ESP. This can be an advantage for tax purposes because it means a larger portion of your benefit will be taxed at the lower rates which applied before 1 July 1983. If you have earlier periods of service you should contact the RBO to find out whether they can count towards your ESP.

Eligible Termination Payment (ETP)

4 The ETP is the lump sum payment of your benefit which will be subject to taxation. The ETP is also the amount of your benefit usually available for "roll-over" (see definition below).

Undeducted Contributions (UDC)

5 Superannuation contributions you have made since 30 June 1983 are known as **undeducted contributions.** Undeducted contributions can only be applied against lump sums which have not been commuted from pensions.

Unused Undeducted Purchase Price (UUPP)

6 Prior to 1 July 1983 you were able to claim some tax relief for superannuation contributions each year when you lodged your tax return but the amount you could claim was limited by the Australian Taxation Office (ATO). If you contributed above the limit set by the ATO, you were allowed to accumulate the excess amounts and then claim them when you retired. Life insurance premiums can also count towards these excess amounts, provided the premiums were paid before 1 July , 1983.

7 The UUPP is the total of the excess amounts mentioned above PLUS an amount equal to your UDC (see paragraph 5).

8 **The UUPP cannot be rolled-over.**

Concessional Component (CC)

9 Some superannuation benefits receive more favourable treatment than others, the CC is one of these. The CC is an amount which is taxed under the more generous rules that existed before 1 July 1983. Very simply, the rules that applied before 1 July 1983 required that only 5% of a superannuation lump sum had to be declared as taxable income. This 5% amount was then taxed at the member's normal rate of tax (i.e. the person's marginal rate). In the DFRDB the only benefit which is eligible for the CC is the lump sum paid when a member is retired on medical grounds as a Class C invalidity.

Pre 83 component and Post 83 component

10 There are two sets of tax rules which apply to lump sums:

a the rules that applied before 1 July 1983; and
b the rules that apply now.

11 Because of this, any ETP must be split into a pre and post 83 component, so that the right tax can be calculated. The split is calculated using the ESP.

12 For example, if you had an ESP of 20 years, say from 1978 until 1998, your pre 83 component would be equal to 5/20ths of your ETP. This is calculated by the number of years from the date you joined the Australian Defence Force until 1 July 1983 over your total ESP. Similarly, your post 83 component would be 15/20ths of your ETP.

13 When the RBO calculates tax, it will actually use the number of days involved, rather than whole years as illustrated above.

Roll-over

14 If you receive an ETP, you may, instead of having the lump sum paid to you, elect to have it paid into one of a number of special funds called Approved Deposit Funds (ADFs), or paid into another superannuation fund or use it to purchase a deferred annuity. This action is called **roll-over.** The advantage of rolling-over is twofold:

1 your benefit will continue to be eligible for the favourable tax treatment offered on superannuation benefits; and

2 after any initial tax deduction arising at the time of lodgement, there will be no tax payable on the benefit or the interest being earned by it until the benefit is actually paid back to you, in the case of deferred annuities, when the deferred annuity becomes payable to you. In other words, it will not be assessed as taxable income while the benefit is kept in the ADF, another superannuation fund or kept as a deferred annuity.

Types of lump sum payments and tax

15 There are four different types of lump sums paid from the DFRDB scheme and each one is treated differently for tax purposes; namely:

1 contribution refunds;
2 gratuities;
3 lump sums on retirement;
4 lump sums on Class C invalidity.

Contribution refunds

16 The entire amount of the refund is considered to be an ETP but the lump sum only comprises your contributions so no tax is payable. However, you are obligated to declare 5% of the pre 83 component when you complete your tax return.

17 **It is important to note that to avoid being incorrectly taxed by the ATO, you should attach a note to your return; requesting that the payment be treated in accordance with paragraph 70 of taxation ruling IT 2168. In your request you should also state that the benefit has been paid from the DFRDB scheme.**

Gratuities

18 The entire amount of a gratuity is considered to be an ETP. The ETP will be split into a pre and post 83 component and tax will be deducted by the RBO from the post 83 component only. You will have to declare 5% of the pre 83 component as taxable income when you complete your tax return.

Lump sums on retirement

19 To receive a lump sum on retirement from the DFRDB scheme, you must exchange some of your retirement pay. The exchange of retirement pay for lump sum is known as **commutation.** Commuted lump sums are treated very differently from other superannuation lump sums.

20 Your ETP in these cases is the amount of lump sum left after deducting your UUPP. Once the UUPP is taken off the lump sum, the remainder will be split into pre and post 83 components. The post component will then be taxed. Again, it is your responsibility to declare 5% of the pre 83 component as taxable income when you complete your return.

Using the UUPP

21 In the DFRDB you can nominate how much, if any, of your UUPP you want to use against the lump sum. The more you use the less the lump sum tax. Although the RBO deducts UUPP from the lump sum to work out your ETP, the UUPP amount will be included in the lump sum paid to you. It will be a tax free amount. If you use all of your UUPP against the lump sum, your retirement pay will be taxed in exactly the same way as your normal salary.

22 An alternative use of your UUPP is to have it applied against your retirement pay. Any UUPP not used against your lump sum can be used to reduce your tax liability on the retirement pay you receive. In this case your UUPP will be divided by your life expectancy at retirement. Where you're married, your spouse's life expectancy will be used if it's greater than yours. This calculation will result in an amount which can be claimed each year to

reduce your taxable income. The claim can be made by you or, in the event that you predecease your spouse, your spouse, for as long as retirement pay or pension is payable.

Lump sums on Class C invalidity

23 These lump sums receive the most favourable tax treatment. The whole of this lump is considered an ETP. A number of steps are taken to calculate the post 83 component:

a your CC is calculated by taking into account your potential service from the date of exit until the date you would have reached your Statutory Retiring Age;

b the CC is then deducted from your lump sum;

c the remaining lump sum is then split into pre and post 83 components;

d your UDC contributions are then deducted from the post 83 component.

If there is a positive amount left in your post 83 component, it will be appropriately taxed. If there is a negative amount left after completing the steps, your post 83 component will be NIL and your pre 83 component will be reduced by the negative amount.

How much tax will I pay ?

24 The RBO will deduct tax from any post 83 component but it is up to you to declare 5% of any pre 83 component as part of your taxable income. This would need to be done in the same tax year you receive the benefit.

25 The rates of tax will depend on your age at the time the benefit is paid and how much of your post 83 component is below the tax threshold. The tax threshold is currently $73,776 but this amount is adjusted each year. If your age is 55 years or older, amounts below the threshold generally attract lower rates of tax than those amounts above the threshold.

26 If you are under age 55 when you receive your lump sum, the post 83 component will be taxed at 31.25% (including the medicare levy). If your age is 55 or over, the post 83 component below the threshold will be taxed at 16.25% and any amount above the threshold will be taxed at 31.25% (both rates include the medicare levy).

What else should I know ?

27 Some or all of an ETP can normally be rolled-over but this action must be carried out within 90 days of receipt of your benefit.

28 You can have the RBO prepare two roll-over cheques for your ETP in favour of an ADF, superannuation fund or deferred annuity, in which case the RBO will not deduct any tax. The cheques in the names of the ADFs or deferred annuities will be sent to your home address so that you can arrange to lodge them. **HOWEVER,** when you roll-over an ETP, the organisation accepting it will be obliged to immediately deduct 15% tax on the post '83 component. When you do finally receive the benefit back, you will be taxed **15% less** on any post 83 component. In the situation where the deferred annuity becomes payable, you will be entitled to claim a pension rebate.

29 Shortly after payment of your lump sum you will receive a document known as a "Statement of Termination Payment" (STP) and a group certificate if the RBO has deducted any tax. The STP will contain the information needed by the ATO. It will set out your pre and post 83 components, your ESP, your UUPP or UDC and any CC you may have.

Need more information ?

30 You can obtain more information about taxation or your benefits from the DFRDB scheme by telephoning the DFRDB Authority on; **(06) 252 6338.**

31 Alternatively, you can write to:

The DFRDB Authority
PO Box 22
Belconnen ACT 2616

or call at the office in Unit 1, Cameron Offices, Chandler Street, Belconnen ACT. If you wish to call at the office you can make an appointment by telephoning **(06) 252 6338.**

32 There are other leaflets which deal with:

Retirement Benefits
Dependants' Benefits
Preserved Benefits
Invalidity Benefits
Appeals Provisions of the DFRDB Scheme