



GUIDANCE NOTE 464
TREATMENT OF ALLOCATIONS FROM RESERVES 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 allocation of amounts from reserves in the fund to members' accounts, where such allocations are in respect of periods after 1 July 1999. For periods prior to 1 July 1999, actuaries should refer to the previous version of this Guidance Note.

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' 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 'contributed amounts' in respect of periods commencing on or after 1 July 1999.

Under this legislation, allocations from reserves held in an accumulation fund to members' accounts will be 'contributed amounts' and hence qualify as 'surchargeable contributions' unless

- a) they qualify as 'amounts attributable to interest', or
- b) the actuary considers that the amounts allocated are 'reasonable'.

The term 'contributed amounts' is 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. (In this Guidance Note, these Acts are collectively referred to as 'the Acts').

The Superannuation Contributions Tax (Assessment and Collection) Regulations 1997 (as amended) and the Superannuation Contributions Tax (Members of Constitutionally Protected Superannuation Funds) Assessment and Collection Regulations 1997 expand the definition of contributed amounts. (In this Guidance Note, these two sets of Regulations are collectively referred to as 'the Regulations').

Regulations numbered 2G in the Regulations set out the conditions under which the fund trustee can determine that an amount allocated from an investment reserve or a miscellaneous reserve in an accumulation fund is 'attributable to interest'. The trustee is not required to obtain actuarial advice in order to make this determination.

Regulations numbered 2H in the respective Regulations provide that an allocation from an investment reserve, a contribution reserve or a miscellaneous reserve in an accumulation fund is a 'contributed amount' if it exceeds an amount that the actuary considers is reasonable. Regulation 2H(b) describes the factors that the actuary is required to consider in determining whether the amount of the allocation is reasonable.

The principles and approaches set out in this Guidance Note are solely for the purposes of determining whether any amount distributed from a reserve in an accumulation fund exceeds a 'reasonable amount' for purposes of Regulation 2H of the Regulations. They are not necessarily appropriate for any other purpose.

DEFINED BENEFIT FUNDS

Except as set out in Section 6, this Guidance Note provides advice only in respect of accumulation funds.

Regulations numbered 2M and Schedules 2 of the Regulations set out how surchargeable contributions for members of defined benefit schemes, including those with accumulation only or accumulation add-on benefits, should be determined. Regulation 2M(4) specifies that surchargeable contributions for accumulation only members are to be determined under the same provisions of the Acts that apply to members of accumulation funds.

Section 6 of this Guidance Note provides guidance to actuaries who are determining Notional Surchargeable Contribution Factors for defined benefit funds with 'accumulation only' benefits.

PERIODS PRIOR TO 1 JULY 1999

Actuaries who are providing advice for accumulation funds in respect of periods prior to 1 July 1999 in relation to the determination of 'Allocated Surplus Amounts' should have regard to the previous version of this Guidance Note dated April 1999.

'Allocated Surplus Amounts' are 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.

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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 determination of 'contributed amounts' for accumulation funds and for the reporting of 'surchargeable contributions' for accumulation only members of defined benefit funds 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.

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 a contributed 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 a contributed 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 a contributed 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 contributed amounts, records should be maintained that would enable the total surplus to be divided into three 'accounts' as follows:

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

The legislation refers to these three types of Reserves but does not define them. These types of Reserves may be maintained for surcharge purposes only and may differ from the reserves required for other purposes of the fund.

In particular, the surcharge legislation applies to surplus in accumulation funds after 1 July 1997 only. It may be necessary for the actuary to determine the balances of such Reserve Accounts for surcharge purposes at that date, or at subsequent dates.

This Guidance Note provides advice to actuaries on the determination of balances in Reserve Accounts for surcharge purposes.

Where the actuary considers that the operation of the fund is such that the intention of this Guidance Note can be met without formally recording some or all of these Reserve Accounts, it is not necessary for such accounts to be formally recorded. 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

may 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 may be classified as the IR component.

If considered appropriate, an actuary may 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 may 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 may 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 should 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 may 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, ie. 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

A distribution from this Reserve will not be regarded as a contributed amount 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 is not considered to have failed to meet the tests in (a) and (b) above merely because different crediting rates (or a different proportion) are applied for different classes of membership. The actuary may take into account the fund's benefit design and the classes of membership which generated the surplus. Different crediting rates are justified 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' account balances, the allocation should usually be based on the account balances at the end of the fund's previous financial year. In particular, 'the member's interest in the scheme' for the purposes of Regulation 2H(b)(ii) should normally be based on the member's account balances in the scheme at the end of the previous financial year. However the actuary may also take into account the credits/debits to those accounts since that date.

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

ALLOCATIONS FROM CONTRIBUTIONS RESERVE

All allocations from this reserve are to be treated as contributed amounts. 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 actually allocated from the Contribution Reserve need be treated as a contributed amount even if an amount grossed up for contribution tax is reported to members as a notional employer contribution.

Where the amounts are used to pay insurance/expenses, the amounts should be apportioned between members in a reasonable manner. The actuary may consider it appropriate to smooth the amounts treated as contributed amounts from year to year.

ALLOCATIONS FROM MISCELLANEOUS RESERVE

Allocations from this Reserve will be considered to be contributed amounts 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 no more than 5% in any year or the amount credited in any year is no more than 5% of a member's account, or such higher amount that the actuary considers is justified by the circumstances. (Only the excess over 5%, or the higher percentage that the actuary considers is justified, should be treated as a contributed amount 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 a contributed amount 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, or such higher amount that the actuary considers is justified by the circumstances.

A particular distribution is not considered to have failed to meet the tests in 1, 2 or 3 above merely because different crediting rates (or a different proportionate credit) are applied for different classes of membership. In determining whether or not the tests are satisfied, the actuary may take account of the fund's benefit design and the classes of membership which 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 the entire surplus could be distributed only to those members who were provided with insurance cover.

Where an allocation is being made in proportion to members' accounts/members' interests in the fund, the allocation should usually be based on the account balances at the end of the fund's previous financial year. However the actuary may also take into account the credit/debits to those accounts since that date.

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

6. MISCELLANEOUS

GROSSING UP FOR CONTRIBUTION TAX

It should be noted that the Acts do not include any provision which requires a gross up of a contributed amount in respect of a member of an accumulation fund for the impact of contributions tax. Therefore no grossing up is required in these cases.

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 after 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 need not in itself require the actuary to treat part or all of a surplus allocation (to either exiting or non-exiting members) as a contributed amount in circumstances where, if there had been no exits, the allocation would not have been treated as a

contributed amount. 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 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 a contributed amount.

ACCUMULATION BENEFITS IN DEFINED BENEFIT FUNDS

Accumulation only members

Under the Regulations, 'accumulation only' members of defined benefit funds are required to be treated in the same manner as members in accumulation funds. As at the first annual review date on or after 30 June 1997, opening balances of the three reserve accounts may need to be established in respect of the accumulation only members.

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 only 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 in respect of the accumulation only members.

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.

Conversion from defined benefits to accumulation benefits

Distributions from surplus in defined benefit funds may occur with an offer to members to convert from defined benefits to accumulation benefits. When considering the application of the legislation and the provisions of this Guidance Note to such circumstances, the actuary should take account of whether the distribution is made:

- a) before the conversion to accumulation benefits; or
- b) in conjunction with (or connection with) the conversion, for instance as part of an enhancement of benefits for those defined benefit members who agree to the conversion; or
- c) after the conversion.

Where surplus is distributed to defined benefit members before a conversion to accumulation benefits (ie. not directly in connection with such a connection), the actuary should have regard to the provisions of Schedule 2 of the Regulations.

Where surplus in a defined benefit scheme is distributed to members as part of an arrangement whereby the members convert from defined benefits to accumulation benefits, the actuary should treat this distribution in accordance with paragraph 25 of Schedule 2 of the Regulations.

Where surplus in a defined benefit scheme is distributed to accumulation only members who were formerly defined benefit members, the actuary should consider whether the distribution is to be treated in as part of the process of conversion to accumulation benefits (as governed by paragraph 25 of Schedule 2), or alternatively as an allocation of reserves for accumulation only members (as described above). Factors that the actuary should take into account would include:

- a) the principles in Section 2 above;
- b) the origin of the surplus being distributed;
- c) the terms under which the members previously transferred from defined to accumulation benefits in the scheme;
- d) the commitments communicated to members on conversion;
- e) the timing of the distribution in relation to that of conversion; and
- f) the purpose of the distribution.

When a conversion from defined benefits to accumulation benefits occurs, the actuary may consider whether an Investment Reserve should be established in respect of those members who transfer to accumulation

benefits. The opening balance of this IR should be determined in accordance with the general principles set out in Section 2 above, taking account of the sources of the surplus, and in particular, excess investment earnings of the fund prior to the conversion.

NON-COMPLYING FUNDS

This Guidance Note should be read as being applicable to complying funds only, on the basis that the definition of 'surchargeable contributions' in the legislation does not include contributions to non-complying funds.

END OF GUIDANCE NOTE 464