

Foreign Superannuation Lump Sums

Applicable Fund Earnings and PAYG Instalments

This information is relevant if you personally receive a lump sum from a foreign superannuation fund, such as a UK pension fund.

Note that a lump sum is taxed differently to regular pension payments, also known as an annuity.

What are applicable fund earnings?

When an Australian tax resident receives a lump sum from a foreign superannuation fund only part of the lump sum may be taxable in Australia.

The taxable part is commonly referred to as the **Applicable Fund Earnings**, or **AFE**.

Broadly, AFE represents the growth in the value of the foreign superannuation fund during your period of Australian tax residence. It is not necessarily the full lump sum received.

For example, if you became an Australian tax resident after joining a foreign pension fund, the AFE calculation generally seeks to tax the growth in the fund after you became an Australian tax resident.

The balance of the lump sum may be non-assessable non-exempt income, depending on the circumstances.

The calculation can be complex and will depend on factors such as:

- when you became an Australian tax resident;
- the value of your foreign pension fund when you became an Australian tax resident;
- contributions made after that date;
- transfers into the fund;
- the value of the fund immediately before payment; and
- exchange rates.

How is AFE taxed?

AFE is not taxed as ordinary income.

Instead, AFE is taxed as **statutory income** under the Australian foreign superannuation fund rules.

For individual taxpayers, this distinction is important because the PAYG instalment system uses different concepts for different purposes. In particular, there is a difference between:

- **instalment income**, which is generally ordinary income; and
- **notional tax**, which is broadly based on adjusted taxable income.

We are in the UK and in Australia:

- UK: 01372 231 185
- Australia: 1300 BDH TAX
(1300 234 829)

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Will AFE cause me to enter the PAYG instalment system?

In isolation - no.

For an individual taxpayer, the ATO generally enters you into the PAYG instalment system if all of the following apply based on your latest tax return and notice of assessment:

- your instalment income from your latest tax return was \$4,000 or more;
- your tax payable on your latest notice of assessment was \$1,000 or more; and
- the ATO estimates that your notional tax is \$500 or more.

The important point is that **AFE is not instalment income for an individual taxpayer.**

This is because for individuals instalment income is based on ordinary income.

AFE is statutory income. Therefore, an AFE amount included in your tax return should not, by itself, cause you to satisfy the \$4,000 instalment income condition.

This means that if the only reason you have a tax liability is because you received a one-off foreign superannuation lump sum with AFE the AFE amount should not, by itself, cause you to enter the PAYG instalment system.

Why can AFE still affect PAYG instalment amounts?

Although AFE should not be instalment income, it may still affect the amount of PAYG instalments calculated by the ATO.

This is because the ATO may calculate PAYG instalments with reference to **GDP-adjusted notional tax.**

GDP-adjusted notional tax is not simply tax on instalment income. It is broadly based on the ATO's estimate of tax on your adjusted taxable income from the most recently assessed tax return, after applying certain adjustments and a GDP uplift.

For this purpose, adjusted taxable income broadly starts with your total assessable income and is then reduced by certain amounts, including net capital gains, deductions other than tax losses, and certain carried-forward tax losses.

This distinction matters for AFE.

AFE is statutory income, so it should not generally be instalment income for an individual taxpayer. However, AFE is still assessable income. It is not a net capital gain. Therefore, where AFE is included in your latest assessed tax return, it may be reflected in the ATO's notional tax calculation.

This means a one-off foreign superannuation lump sum can sometimes increase the ATO-calculated PAYG instalments for the following year, even though the AFE itself is not instalment income.

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What if I am already in PAYG instalments?

If you are already in the PAYG instalment system the treatment depends on the method used to calculate your instalments.

If you use the **instalment rate method**, your quarterly instalment is broadly calculated by applying the relevant instalment rate to your instalment income for the quarter. AFE should not be included in your quarterly instalment income because it is statutory income, not ordinary income.

If you use the **ATO-calculated instalment amount method**, AFE may affect the fixed dollar instalment amount calculated by the ATO, because that amount may be based on GDP-adjusted notional tax from your prior year assessment.

In practical terms a one-off AFE amount can produce PAYG instalments that are too high for the following year if you do not expect to receive a similar foreign superannuation lump sum again.

Practical example – A one-off lump sum from a UK pension fund

You receive a one-off lump sum from a UK pension fund.

Part of the lump sum is taxable in Australia as AFE.

The AFE amount will usually increase your tax payable for that year.

However, because the AFE is statutory income rather than ordinary income it should not, by itself, count towards the \$4,000 instalment income threshold for entering the PAYG instalment system.

If you are already in the PAYG instalment system, or you have other income that causes you to enter the system, the AFE may still affect the ATO's calculation of your PAYG instalments. This is because the ATO's notional tax calculation can take into account the AFE as part of your adjusted taxable income.

If the foreign superannuation lump sum was a one-off payment and you do not expect to receive a similar lump sum in the current year, a **PAYG instalment variation** may be appropriate.

Foreign pension income

Regular foreign pension income is different from AFE.

For example, if you receive regular monthly pension payments from a UK pension fund, those payments are generally taxable in Australia if you are an Australian tax resident.

Unlike AFE, regular foreign pension income is ordinary income. This means it is relevant when working out whether you meet the PAYG instalment entry conditions.

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Accordingly, regular foreign pension income will:

- count towards the \$4,000 instalment income threshold;
- cause you to enter the PAYG instalment system if the other entry conditions are also met; and
- be taken into account when calculating PAYG instalments.

Therefore, while a one-off AFE amount may not, by itself, cause you to enter the PAYG instalment system, regular foreign pension income may do so.

Key points to remember

AFE is the taxable part of a foreign superannuation lump sum.

AFE is statutory income, not ordinary income.

For individual taxpayers, AFE is not instalment income for PAYG instalment purposes.

A one-off AFE amount should not, by itself, cause you to satisfy the \$4,000 instalment income condition for entering the PAYG instalment system.

However, AFE may still affect ATO-calculated PAYG instalment amounts or instalment rates because it can be included in notional tax as part of adjusted taxable income.

Regular foreign pension income is different. It is generally ordinary income and may cause you to enter, or remain in, the PAYG instalment system.

If you receive a PAYG instalment notice after reporting a one-off foreign superannuation lump sum the instalment position should be reviewed before payment is made.

If you are living in Australia and have been in receipt of a lump sum from a foreign pension fund such as a UK pension scheme bdh Tax will be pleased to assist with the calculation of the AFE, and to comment on steps that might be taken to mitigate the tax payable to the ATO.

We can also assist with PAYG instalment variations when we are instructed to assist with your Australian individual tax return.

Please complete the enquiry form at www.bdhtax.com to arrange a free initial conversation about your situation, after which we can send a no obligation fee quote to you.

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