

General Notes - Second Schedule to the Income Tax Act

General Note 5

GENERAL SUBJECT: SECOND SCHEDULE TO THE INCOME TAX ACT

SPECIFIC ASPECT: DETERMINATION OF DEATH BENEFITS

STATUS: DECISION

BACKGROUND: Some approved pension and provident funds are making use of a formula which seems to take into account the number of years of service (period of employment) in determining the value of a benefit payable on the death of a member. The substance of the formula, however, is to provide a benefit which directly relates to the deceased member's annual salary or remuneration and has in fact no relevance to the number of years of service the deceased member had prior to his death.

DECISION: Formula A as defined in paragraph 1 of the Second Schedule (the Schedule) to the Income Tax Act (the Act) describes "N" in the formula as being "the number of completed years (not exceeding fifty) in the period of employment of the taxpayer which, in terms of the rules of the fund in question, is taken into account for the purpose of determining the amount of the benefits payable to him under the fund...". The reference to the rules of the fund is only made, in my opinion, to make it clear that the period of employment must be taken into account in terms of the rules of the fund in determining the benefits payable to the member. It prescribes that, in determining "N", the number of completed years in the period of employment must be included in "N", but only so many years as are taken into account by the rules of the fund to determine the benefits that are payable. My office accepts that a member may wish to purchase a period of employment (past service) which may have been lost during transfer from one fund to another or if the member has had no previous opportunity to become a member of a fund, but I do not accept the purchase of future "employment" or service, that is, any period beyond the actual period of employment.

The formulae currently used by approved pension and provident funds to determine the value of death benefits, including those which artificially refers to the period of employment, do not take into account the number of years of service and are not even remotely related to the number of years of service of the deceased member. In a recent unreported Special Income Tax Court Decision it was confirmed, inter alia, that the number of years of membership must be taken into account for purposes of Formula A and Formula B if the number of years of employment had not been taken into account in determining the death benefit.

Receivers of Revenue have been instructed to, in the case of benefits payable on the death of a member, only take into account the number of years of membership of the fund from which the benefit is payable to a deceased member for purposes of Formulae A and B of the Schedule.

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