Chapter 1
Loss relief and asset roll-over for transfer of amounts to a MySuper product

Outline of chapter

1.1 Schedule # to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to facilitate the Government's MySuper reforms by providing income tax relief to superannuation funds where there is a mandatory transfer of default members' account balances to a MySuper product in another superannuation fund.

1.2 References throughout this chapter are to the ITAA 1997 unless otherwise specified.

Context of amendments

1.3 On 29 May 2009, the Government announced the establishment of the Super System Review (the Review) to comprehensively examine and analyse the governance, efficiency, structure and operation of Australia's superannuation system.

1.4 The Review was conducted with a focus on maximising the retirement incomes for Australians, whilst improving regulation of the superannuation system.

1.5 On 16 December 2010, as part of its response to the Review, the Government announced reforms to the superannuation system called 'Stronger Super'. A key element was the introduction of MySuper from 1 July 2013, a simple and cost-effective superannuation product to replace existing default products.

1.6 MySuper products must have a simple set of product features, irrespective of who provides them. This enables members, employers and market analysts to compare funds more easily based on a few key differences. It also ensures that members do not pay for any features they do not need or use.

1.7 The introduction of MySuper imposes heightened duties on trustees to act in the best financial interests of their members. Trustees have a duty to actively consider whether their investments are of a sufficient scale (in terms of assets and members) to competitively provide a MySuper product.

1.8 For some superannuation funds, this is expected to encourage, or necessitate, the transfer of default members' account balances to other funds. Funds not wishing to offer MySuper products are required under the MySuper rules to transfer existing default members' account benefits to a superannuation fund offering a MySuper product by 1 July 2017.

1.9 If such transfers create an income tax liability from the realisation of fund assets, or if relevant losses remain with the transferring entity, the members whose benefits are transferred would be adversely impacted.

1.10 This is particularly so as superannuation funds typically credit the value of unutilised losses to the account balances of their members. Without allowing a transferring entity to transfer losses to another fund, members' account balances would have to be reduced by the value of those losses.

Summary of new law

1.11 These amendments provide income tax relief to ensure that default members of superannuation funds are not adversely affected if their superannuation benefits are mandatorily transferred to another fund as a result of the MySuper reforms.

1.12 In particular, these amendments ensure that a complying superannuation fund that mandatorily transfers account balances of default members to other funds under the MySuper reforms can:

- transfer losses to other entities; and
- defer an income tax liability for assets transferred to other entities.

1.13 Relief is also provided to life insurance companies and pooled superannuation trusts (PSTs) that the transferring fund invests in to support its default members.

Comparison of key features of new law and current law

New law	*Current law*
Realised capital and tax losses can be transferred from a complying superannuation fund, a life insurance company or a PST to another entity where members' account balances have been mandatorily transferred to a MySuper product in another superannuation fund.	Realised capital and tax losses cannot be transferred from a complying superannuation fund, a life insurance company or a PST where members' account balances have been mandatorily transferred to a MySuper product in another superannuation fund.
Income tax consequences may be deferred where an asset is transferred from a complying superannuation fund, a life insurance company or a PST to another entity where members' account balances have been mandatorily transferred to a MySuper product in another superannuation fund.	Income tax consequences may arise where an asset is transferred from a complying superannuation fund, a life insurance company or a PST to another entity where a members' account balances have been mandatorily transferred to a MySuper product in another superannuation fund.

Detailed explanation of new law

1.14 The introduction of MySuper from 1 July 2013 establishes a new, simple and cost-effective superannuation product to replace existing default products.

1.15 As part of the transition to MySuper, some funds may decide, for example, that they do not have a sufficient investment scale to offer a MySuper product. Under the MySuper provisions, these funds are required to transfer their default members' account balances to a fund offering a MySuper product by 1 July 2017.

1.16 These amendments provide income tax relief to ensure that members are not adversely affected if their superannuation benefits are mandatorily transferred under the MySuper reforms.

What relief is available under these amendments?

1.17 These amendments ensure that a complying superannuation fund can:

- transfer a loss to another entity via the use of a loss transfer (see paragraphs 1.26 to 1.34); and
- defer an income tax liability for assets transferred to another entity (see paragraphs 1.35 to 1.47).

[Schedule #, item 1, sections 311-1 and 311-5 and subsection 311-10(1)]

1.18 Relief is also provided to life insurance companies and PSTs that the transferring fund invests in to support its default members. ***[Schedule #, item 1, subsection 311-10(1)]***

What conditions must be satisfied to access this relief?

1.19 For a transferring entity to access the loss transfer or asset roll-over, it must satisfy four key conditions.

Condition one – certain entities can access relief

1.20 The transferring entity accessing the relief must be a complying superannuation fund, a life insurance company or a PST. This entity must be either the fund that holds the default members' account balances, or be a life insurance company or a PST that the fund invests in to support its default members. ***[Schedule #, item 1, subsection 311-10(2)]***

1.21 Allowing a life insurance company or a PST to access this relief recognises the commercial reality that a significant amount of superannuation is invested by acquiring units in PSTs and insurance policies in life insurance companies rather than being directly invested by the fund.

Condition two - superannuation fund must transfer an accrued default amount and default members

Accrued default amount must be transferred

1.22 The concept of an 'accrued default amount' was introduced to the *Superannuation Industry (Supervision) Act 1993* (SIS Act 1993) by the MySuper reforms. This concept defines amounts which must be moved to a MySuper product by 1 July 2017. Broadly, these amounts are the entire balance of a member's account where an investment choice has not been exercised or if it is held in a default investment option of the fund. ***[Schedule #, item 7, subsection 995-1(1) (definition of 'accrued default amount')]***

1.23 In order for the transferring entity to access income tax relief under these amendments, an accrued default balance must be compulsorily transferred to another fund that offers a MySuper product. Specifically, the relief covers cases where:

- default members of a fund are not eligible to hold a MySuper product in that fund and, as a consequence, their accrued default balance is transferred to another fund offering a MySuper product. This could happen, for example, where the fund offers a tailored MySuper product for a particular workplace and the members are not part of that workplace (see subparagraph 29SAA(1)(b)(i) of the SIS Act 1993); and

- a complying superannuation fund does not offer a MySuper product, and as such it is required to transfer accrued default amounts to another fund offering a MySuper product (see subparagraph 29SAA(1)(b)(i) and section 388 of the SIS Act 1993).

[Schedule #, item 1, paragraphs 311-10(3)(a) and (b)]

Default members must become members of a receiving entity

1.24 The default members must become members of a complying superannuation fund immediately after the accrued default amounts are transferred to that fund. Notwithstanding this, the losses and assets that are subject of this relief must be transferred either to the same fund that the members are transferred to, or to a life insurance company or a PST that the fund invests in to support its default members. ***[Schedule #, item 1, paragraph 311-10(3)(c), section 311-15, and paragraph 311-40(1)(b)]***

Condition three – account balance must be transferred by certain time

1.25 These amendments require that the accrued default amount and the default members must be transferred between 1 July 2013 and 1 July 2017. These dates are consistent with the date of introduction of MySuper and the deadline for the transfer of default members' accrued default amount to a MySuper product. ***[Schedule #, item 1, subsection 311-10(4)]***

Choosing the loss transfer

1.26 A transferring entity that is eligible for, and chooses to access, the loss transfer may transfer realised capital losses and tax losses to a receiving entity to the extent they are attributable to the default member's accrued default amount. The transfer of these losses prevents the value of the losses remaining with the transferring fund and protects the value of the accrued default amount of affected members. ***[Schedule #, item 1, section 311-20]***

1.27 Whilst the transferring entity will hold assets that support its default members, these amendments permit entities to liquidate its assets and then transfer cash and realised losses to the receiving entity. ***[Schedule #, item 1, sections 311-20 and 311-35]***

What losses can be transferred?

1.28 Where the loss transfer is chosen by a transferring entity, the capital and tax losses that can be transferred are determined by reference to whether the losses (and the underlying assets that generate the losses) are reasonably attributable to the accrued default balance of the default members. In addition, where the entity accessing the relief is a life insurance company or a PST, the losses must be reflected in the value of the fund's interest in the life insurance policy or the units in the PST. ***[Schedule #, item 1, subsections 311-20(2), (3) and (4)]***

1.29 Where a transferring entity generates losses from the realisation of assets after the default members have been transferred to another fund, these amendments ensure that these losses can also be transferred to a receiving entity to the extent that the losses are attributable to the accrued default amounts of former members. This ensures that the amendments do not restrict when a transferring entity must realise its assets to fund the transfer of members to another fund. ***[Schedule #, item 1, section 311-35]***

What is the effect of transferring a capital loss?

1.30 If the transferring entity transfers realised capital losses to a receiving entity, it reduces its capital losses by the transferred amount. A corresponding loss is taken to have been made by the receiving entity on the day the default members accrued default amounts are transferred. This ensures that the receiving entity can utilise the transferred loss against capital gains in that, or a future, income year. ***[Schedule #, item 1, section 311-25]***

1.31 Life insurance companies are required to separately segregate assets that support complying superannuation/First Home Saver Account (FHSA) policies under Division 320. Therefore, if the receiving entity is a life insurance company, the transferred capital loss is taken to be a loss from its complying superannuation/FHSA assets. This provides integrity by ensuring that losses from superannuation assets cannot be used to offset gains made from the ordinary asset class of a life insurance company. ***[Schedule #, item 1, paragraph 311-25(c)]***

Example 1.1: Superannuation fund transfers capital losses

Small Super, a complying superannuation fund, has default and choice superannuation members. As a result of the MySuper reforms, Small Super has decided not to offer a MySuper product, as it would not be able to have sufficient investment scale to competitively provide such products to its default members.

On 10 August 2013, Small Super transfers the accrued default amounts of its members to a MySuper product offered by Big Super. It has agreed to pay $4 million in cash by realising assets that are attributable to its default members. As part of this transaction, it also transfers $220,000 in capital losses comprised of $200,000 of earlier year net capital losses and $20,000 of transfer year capital losses.

Under these amendments, Small Super is taken to not have made those losses and Big Super will recognise $220,000 of capital losses in determining its net capital gain or net capital loss for the 2013-14 income year. It will carry forward any unutilised losses to future income years.

What is the effect of transferring a tax loss?

1.32 If the transferring entity transfers realised tax losses to a receiving entity, it reduces its tax losses by the transferred amount. A corresponding loss is taken to have been incurred by the receiving entity on the day the default members accrued default amounts are transferred. ***[Schedule #, item 1, paragraphs 311-30(a), (b) and (d)]***

1.33 In relation to section 36-15, if a taxpayer has more deductions for an income year than assessable income, the difference is a tax loss which may be deducted in a later income year. Therefore, to enable the receiving entity to deduct losses in the year of the account transfer, these amendments ensure that, for the purpose of section 36-15, the amount of the loss is taken to have been incurred by the receiving entity for the income year immediately prior to the transfer year. ***[Schedule #, item 1, paragraph 311-30(c)].***

1.34 Similar to capital losses, if the receiving entity is a life insurance company, the transferred tax loss is taken to be a loss from its complying superannuation/FHSA assets. Again, this ensures that losses from superannuation assets cannot be used to offset gains made from the ordinary asset class of a life insurance company. ***[Schedule #, item 1, subparagraphs 311-30(c)(i) and (d)(i)]***

Example 1.2: Superannuation fund transfers tax losses

Following on from Example 1.1, Small Super transfers realised tax losses of $25,000, comprising a loss of $20,000 from a previous income year and $5,000 from the income year that members' accrued default amounts are transferred.

Under these amendments, Small Super is taken to not have made those losses. Furthermore, for the purposes of section 36-15, the losses are taken to have been incurred by Big Super for the income year immediately prior to the transfer year (that is, immediately before the 2013-14 income year). This ensures that Big Super takes into account the loss of $25,000 in working out its taxable income for the 2013-14 income year.

Choosing the asset roll-over

1.35 Complying superannuation funds, life insurance companies and PSTs may choose an optional CGT, depreciating asset and revenue asset roll-over for each asset that is transferred, provided they meet the gateway conditions discussed in paragraphs 1.19 to 1.25. ***[Schedule #, item 1, subsection 311-40(1)]***

1.36 Where an asset roll-over is not chosen by the transferring entity, the entity may be able to transfer losses in respect of that asset if a loss arises as part of the realisation.

What assets are eligible for an asset roll-over?

1.37 Where a transferring entity chooses to transfer assets to a receiving fund, it can also choose a roll-over for those assets if they are reasonably attributable to the accrued default balance of the default members. In addition, where the entity accessing the relief is a life insurance company or a PST, the assets must be reflected in the value of the fund's interest in the life insurance policy or the units in the PST. ***[Schedule #, item 1, subsection 311-40(2)]***

Consequences of choosing asset roll-over for CGT assets

1.38 Section 295-85 makes the CGT regime the primary code for determining the tax consequences of the gains or losses generated on the realisation of certain assets owned by a complying superannuation fund or a PST. Section 320-45 provides for the same rules to apply for the complying superannuation/FHSA assets of life insurance companies.

1.39 If the asset roll-over is chosen by the transferring entity, it disregards any CGT consequences associated with the asset transfer. Also, the receiving entity is treated as having acquired the asset for the transferring entity's cost base (and reduced cost base). This ensures that any CGT consequences are deferred until a later dealing with that asset by the receiving entity. ***[Schedule #, item 1, section 311-45]***

Asset's date of acquisition

1.40 For assets subject to the CGT roll-over, the general acquisition rules in Subdivision 109-A apply — that is, the receiving entity acquires the asset when the asset is transferred to that entity.

1.41 However, for the purposes of the receiving entity satisfying the 12-month CGT discount ownership requirement (see subsection 115-25), these amendments recognise the period of ownership when the asset was owned by the transferring entity. ***[Schedule #, item 4, subsection 115-30(1) (table item 11)]***

1.42 Section 295-90 treats the trustee of a complying superannuation fund and a PST as having acquired on 30 June 1988 any assets it already owned on that date. An equivalent rule applies to life insurance companies in relation to complying superannuation/FHSA assets (see section 320-45). Therefore, as these entities will not own assets that are acquired before the introduction of the CGT regime on 20 September 1985, there is no need for the CGT roll-over to deal with pre-CGT assets.

Example 1.3: Superannuation fund chooses CGT roll-over

Pencil Super has decided not to offer a MySuper product to its default members. As part of an arrangement entered into with Pen Super, Pencil has agreed to transfer all of its default members to Pen. All assets that are reasonably attributable to the members' accrued account balances are also transferred to Pen.

Pencil owns a share in Sharpener Limited and its cost base (and reduced cost base) is $10.

Under these amendments, any CGT consequences associated with the transfer of the share from Pencil to Pen are disregarded for Pencil. Furthermore, for Pen, the asset has a cost base (and reduced cost base) of $10. This ensures that any CGT consequences associated with the transfer are deferred until a later dealing with that asset by Pen.

For the purposes of the CGT discount, Pen is treated as acquiring the share at the time when Pencil acquired the share.

Consequences of choosing asset roll-over for depreciating assets

1.43 Superannuation funds may own some depreciating assets. If such assets are transferred to a receiving entity, this will cause a balancing adjustment event to occur (see section 40-295).

1.44 Where there is a difference between the asset's termination value (that is, the market value of the asset at the transfer date) and its adjustable value (that is, the original cost less the decline in value while it was held by the entity), a balancing adjustment event may result in an amount being assessable or deductible through the operation of section 40-285.

1.45 These amendments ensure that, if the asset roll-over is chosen by the transferring entity, section 40-285 does not apply to the transfer of the depreciating assets. This ensures that any income tax consequences associated with the depreciating asset are deferred until a further balancing adjustment event happens to the asset in the hands of the receiving entity. ***[Schedule #, item 2, subsection 40-340(1) (table item 7)]***

Consequences of choosing asset roll-over for revenue assets

1.46 A revenue asset is an asset for which a profit or loss on disposal or ceasing to own the asset is taken into account in calculating assessable income other than as a capital gain or capital loss (see section 977-50). The asset must be neither trading stock nor a depreciating asset.

1.47 For revenue assets subject to the asset roll-over, the transferring entity is taken to have realised the asset for an amount that would result in them not making a profit or loss on that realisation. Furthermore, the receiving entity is taken to have acquired the revenue asset for that amount. This ensures that any income tax consequences are deferred until a later dealing with that asset by the receiving entity. ***[Schedule #, item 1, section 311-50]***

Example 1.4: Superannuation fund chooses revenue asset roll-over

> Further to Example 1.3, as part of the transfer of assets from Pencil to Pen, Pencil transfers all of its revenue assets to Pen, where they are also treated as revenue assets of Pen.
>
> In relation to one of Pencil's assets that it accounts for on revenue account, the market value is $200,000 and the cost was $120,000.
>
> Under these amendments, on the transfer of the asset, Pencil is treated as if it has received $120,000 for that asset. In addition, Pen is treated

as having acquired that asset for $120,000. This ensures that any income tax consequences associated with the transfer are deferred until a later dealing with that asset by Pen.

Method for making the choice to transfer loss or roll over asset

1.48 The choice to access this relief will have specific consequences for both the transferring and the receiving entity. Therefore, whilst only the transferring entity is required to choose this relief, the consequences associated with accessing the relief would usually be considered by both parties during the negotiation of the transfer of the accrued default amounts of members.

1.49 The transferring entity's choice to access the relief will be evidenced by the manner in which it completes its income tax return for the income year in which the accrued default balances are transferred. This mechanism is based on section 103-25, which applies to choices made under the CGT provisions. ***[Schedule #, item 1, section 311-60]***

Application provisions

1.50 These amendments apply where member's accrued default amounts are transferred between 1 July 2013 and 1 July 2017. These dates are consistent with the date of introduction of MySuper and the deadline for the transfer of default members' accrued default amount to a MySuper product. ***[Schedule #, item 1, subsection 311-10(4)]***

Repeal provisions

1.51 These amendments will be automatically repealed on 2 July 2019. This recognises the fact that the amendments cease to apply at the end of 1 July 2017. ***[Schedule #, items 8 to 14]***

Consequential amendments

Further consequences for a transferring entity or receiving entity that is a life insurance company

1.52 Where a complying superannuation/FHSA asset is transferred to or from a life insurance company, a deemed sale or deemed acquisition of the asset for its market value may occur under section 320-200.

1.53 To ensure the CGT, depreciating asset and revenue asset roll-overs provided by these amendments is not overridden by a deemed sale or acquisition of the asset under section 320-200, these amendments provide that section 320-200 does not apply in relation to asset realisations subject to the asset roll-over. ***[Schedule #, item 1, subsection 311-55(1)]***

1.54 Similarly, where the receiving entity is a life insurance company, an asset acquired under the asset roll-over is taken to be a complying superannuation/FHSA asset of the company, and not life insurance premiums relating to that asset class, which would otherwise be assessable. This rule, which broadly resembles sections 320-315 and 320-320 that apply to life insurance business transfers, ensures that the Division 320 life insurance business taxation provisions do not override the relief provided by these amendments. ***[Schedule #, item 1, subsection 311-55(2)]***

Claiming a tax deduction where a member has been mandatorily transferred under the MySuper reforms

1.55 Members who make a personal contribution to a complying superannuation fund may be able to claim an income tax deduction if they give a notice to that fund and the conditions of Subdivision 290-C are satisfied. However, an individual cannot give such a notice to a complying superannuation fund if they have ceased to be a member of the fund.

1.56 These amendments provide that, where members have not given a notice in relation to their contribution to the original superannuation fund before their accrued default amount is mandatorily transferred to another fund, they are able to give their notice to their new fund and still receive an income tax deduction in respect of their contribution. This change ensures that fund members affected by a mandatory MySuper transfer are not disadvantaged by losing their ability to claim a personal tax deduction. ***[Schedule #, items 5 and 6, subsections 290-170(6) and 290-180(6)]***

1.57 Currently, there is an exception to the rule described in paragraph 1.55 which ensures that members who are automatically transferred to another fund under the successor fund transfer rules are able to retain their ability to claim a personal tax deduction. This rule is not applicable to these amendments, as the successor fund transfer rules, which apply when members are compulsorily transferred to other funds, do not apply to mandatory MySuper transfers.

Guide material

1.58 The guide material in section 112-97 that lists the cost base modifications outside of the core CGT provisions (Part 3-1 and 3-3 of the ITAA 1997) is amended to include the CGT roll-over provided by these amendments. ***[Schedule #, item 3, section 112-97 (table item 36)]***