
General outline and financial impact

Limiting the trading stock exception for superannuation funds

Schedule # to this Bill amends the *Income Tax Assessment Act 1997* to remove access to the trading stock exception to the capital gains tax primary code rule for certain assets (primarily shares, units in a trust and land) owned by a complying superannuation entity.

Date of effect: These amendments apply from 7.30pm (AEST) on 10 May 2011. Assets owned by the entity and held as trading stock prior to that time can continue to be treated as trading stock of the entity.

Proposal announced: This measure was announced on 10 May 2011 as part of the 2011-12 Budget.

Financial impact: This measure has these revenue implications:

2010-11	2011-12	2012-13	2013-14	2014-15
nil	nil	\$5m	\$5m	\$5m

Compliance cost impact: Low overall, comprising a low implementation impact and a decrease in ongoing compliance costs.

Limiting the trading stock exception for superannuation funds

Outline of chapter

1.1 Schedule # to this Bill amends the *Income Tax Assessment Act 1997* to remove access to the trading stock exception to the capital gains tax (CGT) primary code rule for certain assets (primarily shares, units in a trust and land) owned by a complying superannuation entity.

Context of amendments

1.2 The CGT primary code rule in section 295-85 ensures that gains and losses on most assets owned by complying superannuation entities are taxed according to the CGT provisions.

- A complying superannuation entity is defined in section 995-1 as a complying superannuation fund, a complying approved deposit fund or a pooled superannuation trust.
- Section 320-45 ensures that gains and losses on complying superannuation/first home saver account (FHSA) assets of a life insurance company are also taxed according to the CGT primary code rule.

1.3 There are a number of exceptions to the CGT primary code rule that ensure that gains and losses on certain assets are taxed on revenue account, where appropriate. One of those exceptions is trading stock held by a relevant entity.

1.4 The general industry practice, as set by large superannuation entities, is to tax gains and losses on share transactions according to the CGT provisions.

1.5 However, during the recent economic downturn, a number of superannuation entities sought, for the first time, to treat some of their shares as trading stock.

1.6 Some entities sought to treat some shares as trading stock in order to use losses made in relation to those shares against non-CGT income (such as dividends or interest), despite in earlier income years using the CGT provisions for shares where a gain was made in order to benefit from the CGT discount.

1.7 This practice creates potential uncertainty regarding the appropriate tax treatment of gains and losses made from the sale of shares owned by complying superannuation entities. This has created the need to amend the law to remove the present ambiguity around the application of the trading stock provisions.

Summary of new law

1.8 These amendments remove access to the trading stock exception to the CGT primary code rule for certain assets (primarily shares, units in a trust and land) owned by a complying superannuation entity.

- This is consistent with CGT being the primary code for taxing gains and losses of complying superannuation entities

1.9 This is achieved by excluding certain assets (primarily shares, units in a unit trust and land) from the definition of trading stock for these entities.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
Complying superannuation entities cannot account for gains and losses on certain assets (primarily shares, units in a unit trust and land) on revenue account using the trading stock exception.	Complying superannuation entities account for gains and losses on any type of trading stock asset (including shares, units in a unit trust and land) on revenue account, using the trading stock exception.
Life insurance companies cannot account for gains and losses on certain complying superannuation/FHSA assets (primarily shares, units in a unit trust and land) on revenue account using the trading stock exception.	Life insurance companies that own certain complying superannuation/FHSA assets that are trading stock (including shares, units in a unit trust and land) account for gains and losses on these assets on revenue account, using the trading stock exception.

Detailed explanation of new law

1.10 These amendments remove access to the trading stock exception to the CGT primary code rule for certain assets (primarily shares, units in a trust and land) owned by a complying superannuation entity. *[Schedule #, items 1 to 4, section 70-10]*

- These amendments apply in the same way to complying superannuation/FHSA assets of a life insurance company, to ensure that these assets continue to be taxed in the same way as assets of a complying superannuation entity.

1.11 This is achieved by modifying the definition of trading stock in section 70-10 for complying superannuation entities to exclude all assets covered by section 275-105 ('covered assets'). The following assets are covered by section 275-105 and are subject to the MIT choice of capital treatment rules:

- a share in a company (including a share in a foreign hybrid company);
- a non-share equity interest in a company;
- a unit in a unit trust;
- land (including an interest in land); or
- a right or option to acquire or dispose of one of the assets listed directly above.

However, if one of these assets is a Division 230 financial arrangement or a debt interest, it is not a covered asset.

[Schedule #, items 1 to 4, section 70-10]

1.12 The modified definition of trading stock will also have the effect of excluding covered assets that are complying superannuation/FHSA assets of a life insurance company. *[Schedule #, items 1 to 4, section 70-10]*

1.13 These changes ensure that complying superannuation entities and life insurance companies cannot access the trading stock exception to the CGT primary code rule in item 5 of subsection 295-85(4), in relation to these covered assets.

- A note is inserted to alert taxpayers accessing the CGT primary code rule in section 295-85 to the modification of the

trading stock definition for complying superannuation entities and life insurance companies. *[Schedule #, item 5]*

1.14 This amendment will ensure consistent treatment of covered assets whether the investment in those assets is made by a complying superannuation entity, a life insurance company (for complying superannuation/FHSA assets), or a managed investment trust (MIT) that is subject to the MIT choice of capital treatment rules.

Example 1.1

Smith Super Fund (Smith) is a self-managed superannuation fund. Between 1 July 2011 and 30 June 2012, Smith buys and sells a large volume of shares for the purpose of providing for the retirement of the fund's members.

To prepare Smith's income tax return for the 2011-12 income year, Smith works out whether there has been a capital gain or capital loss on each share that was disposed of during the year.

Smith does not need to consider whether the buying and selling of shares would qualify as being in the business of share trading, or whether the shares that were bought and sold during the income year would be trading stock.

Application provisions

1.15 These amendments apply from 7.30pm (AEST) on 10 May 2011. Assets owned by the entity and held as trading stock prior to that time can continue to be treated as trading stock of the entity. *[Schedule #, item 6]*

1.16 These amendments are retrospective to ensure that transactions that have occurred since these changes were announced are covered by these amendments as intended by the Budget announcement.