Tax
10 Shelley Street
Sydney NSW 2000

P O Box H67
Australia Square 1213
Australia

ABN: 51 194 660 183
Telephone: +61 2 9335 7000
Facsimile: +61 2 9335 7001
DX: 1056 Sydney
www.kpmg.com.au

General Manager
Business Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Our ref 15535966_1

Contact Tony Mulveney (02) 9335 7121

Attention: Ly Mai

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Dear Ly

Tax relief for merging superannuation funds

We refer to the Exposure Draft materials released by the Minister for Financial Services and Superannuation which are intended to provide income tax relief for merging superannuation funds. Our submission below focuses on the intended effect of transferring a loss.

It is explained in the Exposure Explanatory Memorandum that loss relief and asset roll-over measures are intended to remove income tax impediments to mergers between complying superannuation funds by permitting the roll-over of both revenue gains or losses and capital gains or losses. Tax considerations are a major impediment to mergers as trustees of superannuation funds must consider the adverse tax impacts on members accounts. The trustee may decide to abandon any merger plans where there is a significant negative impact on member's benefits – which can include the extinguishment of losses (either capital losses and/or revenue losses).

Subdivision 310-C of the Exposure Draft is intended to allow for tax losses to be transferred to the receiving entity upon a merger of superannuation funds. Paragraphs 1.28 and 1.31 of the Explanatory Memorandum indicate the intention is for the receiving entity to be able to use the losses both in the year of transfer and future years. However, it would appear that the proposed amendments in the Exposure Draft will not have the effect of enabling the receiving entity to utilise a tax loss in the year of transfer.

Items 6 and 7 of the Exposure Draft amend subparagraphs 310-35 and 310-40 of the Income Tax Assessment Act 1997 ("ITAA 97") respectively to deem a transferred capital loss (section 310-35) and transferred tax loss (section 310-40) to be a loss made by the receiving entity for the transfer year. Section 36-14 of the ITAA 97 permits a tax loss to be deducted in later income years. The effect of section 36-15 will be that the tax loss transferred to the receiving entity may only be utilised by the receiving entity in the year <u>after</u> transfer (which is not consistent with paragraph 1.31 of the Explanatory Memorandum).

This anomaly could be rectified in at least one of two ways:

- deeming the tax loss to have been made by the receiving entity in the year prior to the transfer year; or,
- stipulating that the receiving entity may utilise the tax loss for the income year of transfer.

We consider it would be more appropriate to enable the receiving company to utilise the tax loss in the year of transfer. Our reasons for reaching this conclusion are set out below.

If the tax loss was deemed to have been made by the receiving entity in the year prior to the transfer year, then the tax loss would be reduced by the exempt income of the receiving entity for the subsequent year (i.e. the transfer year) under section 36-15. That same tax loss may already have been reduced under 36-15 for the exempt income of the transferring entity in the income year (i.e. where some part of the tax loss is utilised by the transferring entity for the transfer year). In these circumstances it would appear to be a double application of section 36-15.

In addition, the potential impact of section 36-15 on the transferred losses would need to be considered by the trustees of the transferring entity. If, for example, the receiving entity had a significant number of members in the pension phase then it would likely have significant exempt income with corresponding detrimental impact on transferred losses. If such tax considerations precluded the trustees from recommending the relevant merger then it would appear contrary to the intention of the amendments.

The recommended approach would also enable both subparagraph 310-35 and subparagraph 310-40 to be consistent in terms of deeming the capital loss/tax loss to be made by the receiving entity for the transfer year.

For the reasons set out above we consider the preferred approach would be to enable the receiving entity to utilise all the tax loss against the assessable income of the receiving entity in the transfer year.

If you would like to discuss any aspects of this submission please contact Tony Mulveney on (02) 9335 7121 or Bernard Finnegan on (02) 9335 7106

Yours faithfully

Tony Mulveney
Partner