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## **General outline and financial impact**

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### **Taxation relief for merging superannuation funds**

Schedule # to this Bill amends the *Income Tax Assessment Act 1997* and *Tax Laws Amendment (2009 Measures No. 6) Act 2010* to reinstate the temporary loss relief for merging superannuation funds with some modifications.

**Date of effect:** This measure is available for mergers that occur on or after 1 October 2011 and before 2 July 2017.

**Proposal announced:** This measure was announced in the Minister for Financial Services and Superannuation's Media Release No. 020 of 24 April 2012.

**Financial impact:** This measure has the following revenue implications:

<b>2012-13</b>	<b>2013-14</b>	<b>2014-15</b>	<b>2015-16</b>
-	\$5.0m	\$5.0m	\$5.0m

**Human rights implications:** This Schedule does not raise any human rights issue. See *Statement of Compatibility with Human Rights* — Chapter [#], paragraphs [1.49 to 1.52].

**Compliance cost impact:** This measure is expected to have a low overall compliance cost impact, comprised of a low implementation impact and a low decrease in ongoing compliance costs.

# Chapter 1

## Taxation relief for merging superannuation funds

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### Outline of chapter

1.1 Schedule # to this Bill reinstates the temporary loss relief and asset roll-over in Division 310 of the *Income Tax Assessment Act 1997* (ITAA 1997) with the following modifications:

- an optional asset roll-over for capital gains and revenue gains;
- losses that are transferred to the receiving entity will be treated as having been made in the income year that they were transferred; and
- the exclusion of self-managed superannuation funds.

1.2 The loss relief and asset-roll-over removes 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. This loss relief will be available for complying superannuation funds (other than self-managed superannuation funds) and approved deposits funds (ADFs) that merge with a complying superannuation fund with five or more members.

### Context of amendments

1.3 Capital gains tax (CGT) is the primary code for calculating gains or losses of complying superannuation funds. There are certain gains and losses that are treated on revenue account, such as those from a debenture stock or bond (see section 295-85 of the ITAA 1997).

1.4 The transfer of assets from one superannuation fund to another, under a merger between the two funds, will typically trigger CGT event A1 (about disposals of a CGT asset — section 104-10 of the ITAA 1997) or may trigger CGT event E2 (about transferring a CGT asset to a trust — section 104-60 of the ITAA 1997). Therefore, the asset transfer will lead to the realisation of capital gains and/or capital losses for the transferring fund. Following this asset transfer and the transfer of

members' accounts to the receiving fund, the transferring fund will typically be wound up.

1.5 Capital losses are extinguished on the ending of an entity. As capital losses can be used to offset present and future capital gains, they carry some value — at most the value of the tax liability that would otherwise be payable on the reduced capital gains. This value is extinguished on the winding up of the transferring superannuation fund.

1.6 Similarly, revenue losses, such as foreign exchange losses, are also extinguished on the ending of an entity. Revenue losses also have a value as they can be offset against current year income, or carried forward where the entity continues to exist. However, where there is a merger and the transferring entity ceases to exist, the value of the revenue losses is also extinguished.

1.7 Valuations of members' superannuation interests may include the tax benefits of unrealised net capital losses or revenue losses. In the absence of optional loss relief and asset roll-over a merger may lead to a reduction in the value of members' superannuation interests. This can act as an obstacle to the superannuation fund merging with another fund because the trustee has to take this reduction into account when considering such a merger. The trustee may decide to abandon any merger plans where there is a significant negative impact on members' benefits. The optional loss relief and asset roll-over removes the impediment to eligible funds merging that would otherwise arise from the extinguishment of the losses.

1.8 This loss relief encompasses transfers to and from pooled superannuation trusts (PSTs) and life insurance companies as well as superannuation funds and ADFs. Providing the loss relief to superannuation fund mergers involving these kinds of entities recognises the commercial reality that a significant amount of superannuation is invested via PSTs and life insurance companies rather than being directly invested by the superannuation fund.

1.9 The loss relief and asset roll-over in Division 310 was introduced as a temporary concession to assist the superannuation industry to cope with the severe economic and financial market conditions in late 2008. The temporary loss relief and asset roll-over was granted for transfer events happening on or after 24 December 2008 and before 1 October 2011.

1.10 The rationale for reinstating the taxation relief is to facilitate the implementation of the Stronger Super reforms. The Government's Stronger Super reforms will put pressure on superannuation funds to improve their competitiveness or reassess their viability in the absence of

merging with another entity. Stronger Super encourages increased size or scale of superannuation funds to enable funds to provide a range of benefits to members, including lower fees through administrative efficiency and greater returns and diversification of investment through additional investment weight.

1.11 Tax considerations are a major impediment to mergers as trustees of superannuation funds must consider the adverse tax impacts on members' accounts. Although a merger may be in the long-term interest of members, the effect on members' account balances may preclude this from happening.

1.12 Given the potential benefits to members of facilitating industry consolidation and the possible costs for some entities transitioning to Stronger Super, temporary taxation relief in the form of loss relief and asset roll-over for mergers of superannuation funds is appropriate.

## **Summary of new law**

1.13 This measure reinstates Division 310 with some modifications to allow a complying superannuation fund (other than a self-managed superannuation fund) or a complying ADF to choose to roll-over revenue gains or losses and capital gains or losses arising from an arrangement to merge the fund with a complying superannuation fund with five or more members. This is achieved through the provision of a loss transfer and an asset roll-over.

1.14 The transferring entity may also transfer previously realised capital losses and revenue losses, including its prior year losses. Losses that are transferred will be taken to be incurred by the receiving entity in the year of transfer.

1.15 The amendments to Division 310 allow transferring entities greater flexibility when choosing the asset roll-over.

## Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
A merging superannuation fund may choose loss relief where the transferring entity transfers assets to the receiving entity on or after 1 October 2011 and before 2 July 2017.	A merging superannuation fund may choose loss relief for an eligible fund merger where the transferring entity transfers assets to the receiving entity on or after 24 December 2008 and before 1 October 2011.
Trustees of self-managed superannuation funds are excluded from choosing the loss relief and the asset roll-over.	Trustees of self-managed superannuation funds may currently be eligible to choose the loss relief and the asset roll-over where they enter into an arrangement to merge with a complying superannuation fund with five or more members.
Earlier year capital losses that are transferred to a receiving entity are taken to be made by the receiving entity in the year that the losses are transferred.	Earlier year capital losses that are transferred to a receiving entity are taken to be made by the receiving entity for that earlier year.
Earlier year tax losses that are transferred to a receiving entity are taken to be made by the receiving entity in the year that the losses are transferred.	Earlier year tax losses that are transferred to a receiving entity are taken to be made by the receiving entity for that earlier year.
Access to both options under the asset roll-over is available regardless of the net capital position of the entity, in relation to the transferred assets.	Two options for the asset roll-over are available depending on the net capital position of the entity, in relation to the transferred assets. If an entity is in a net capital loss position in relation to the transferred assets for the current year, it may choose either the global asset approach or the individual asset approach. If the entity is not in that position, it can only choose the individual asset approach.
Access to both options under the asset roll-over is available regardless of the net revenue position of the entity, in relation to the transferred assets.	Two options for the asset roll-over are available depending on the net revenue position of the entity, in relation to the transferred assets. If an entity is in a net revenue loss position in relation to the transferred assets for the current year, it may choose either the global asset approach or the individual asset approach. If the entity is not in that

	position, it can only choose the individual asset approach.
An entity can disregard any capital gain or loss under the individual asset approach.	An entity can disregard any capital loss under the individual asset approach.
An entity can disregard any assessable income or tax loss with respect to its revenue assets under the individual asset approach.	An entity can disregard any tax loss with respect to its revenue assets under the individual asset approach.

## Detailed explanation of new law

### Reinstatement of the loss relief and asset roll-over

1.16 To reinstate Division 310, the application and repeal provisions for the loss relief and asset roll-over in the *Tax Laws Amendment (2009 Measures No. 6 Act) 2010* are amended to allow the provisions to apply from 1 October 2011 to 1 July 2017. [Schedule #, Part 1, item 2]

1.17 Several minor amendments and updates have been made to a number of provisions as a result of the reinstatement and modifications made to Division 310. [Schedule #, Part 1, item 3 and, item 4. Schedule #, Part 2, item 9, 11, 14 and 16.]

### What entity may choose the loss transfer and asset roll-over

1.18 A trustee of a complying superannuation fund (other than a self-managed superannuation fund) is eligible to choose the optional loss transfer and asset roll-over when there is an arrangement to merge complying superannuation funds [Schedule #, Part 2, item 5]

1.19 An eligible entity with an arrangement to merge superannuation funds may choose:

- a loss transfer only;
- an asset roll-over only; or
- a combination of the loss transfer and the asset roll-over,

where the relevant conditions are satisfied.

1.20 Eligibility for the asset roll-over is conditional on an entity being eligible for the loss transfer, but will not be dependent on the entity

actually choosing the loss transfer. This will permit an arrangement to merge superannuation funds to occur in the following ways:

- the transfer of cash only following the disposal of all the transferring entity's assets;
- the transfer of other assets only; or
- a combination of cash and asset transfers.

### **When an entity may choose the loss transfer and asset roll-over**

1.21 Subdivision 310-B sets out the conditions that must exist for an entity to choose the loss transfer and the asset roll-over in respect of an arrangement to merge superannuation funds.

1.22 Subdivision 310-B specifies separately the different ways in which a complying superannuation fund or ADF may hold assets. Assets may be held directly, through a pooled superannuation trust (PST) or through a policy with a life insurance company.

### **Consequences of choosing to transfer losses**

1.23 Subdivision 310-C sets out who losses can be transferred to, the losses that can be transferred and the effect of transferring a loss.

1.24 Section 310-25 provides that losses may be transferred to one or more of the following entities, called receiving entities:

- a continuing fund for the loss relief;
- a PST in which the units are held by a continuing fund for the loss relief just after the completion time of the arrangement to merge the funds; and/or
- a life insurance company which has issued a complying superannuation/FHSA life insurance policy that is held by a continuing fund for the loss relief just after the completion time.

1.25 Section 310-30 provides that the losses that may be transferred are capital losses and revenue losses realised before the merger, specifically:



- net capital losses for earlier income years than the transfer year to the extent that they were not utilised before the completion time;
- net capital losses for the transfer year, worked out as if the transfer year ended at the completion time;
- tax losses for earlier income years than the transfer year to the extent that they were not utilised before the completion time; and
- tax losses incurred for the transfer year, worked out as if the transfer year ended at the completion time.

***Effect of transferring a capital loss***

1.26 The previously realised net capital loss for an income year that is not the transfer year will be taken, if it is transferred, not to have been made by the transferring entity for that earlier income year.

1.27 An amount equal to the transferred loss will be taken to have been made by the receiving entity in the transfer year. [*Schedule #, Part 2, item 6*]

1.28 The receiving entity will therefore be able to utilise the transferred capital losses against capital income only in the income year that the losses are transferred or in future income years.

***Effect of transferring a tax loss***

1.29 Similar to capital losses, an earlier year tax loss can be transferred to a receiving entity by the transferring entity. As a result, the transferring entity will be taken not to have incurred the loss for that earlier income year.

1.30 An amount equal to the transferred loss will be taken to have been made by the receiving entity in the transfer year. [*Schedule #, Part 2, item 7*]

1.31 The receiving entity will therefore be able to utilise the transferred tax losses against income only in the income year that the losses are transferred or in future income years.

**Roll-over for assets**

1.32 Subdivision 310-D provides that superannuation funds, ADFs, PSTs and life insurance companies that meet the eligibility conditions for

the loss transfer may also choose a roll-over for assets transferred from the transferring entity to the receiving entity provided certain additional conditions are satisfied.

1.33 Section 310-45 specifically lists the three additional conditions for the asset roll-over which must be satisfied.

### **Choosing the form of the asset roll-over**

1.34 An entity may choose between two methods for executing the roll-over regardless of the entity's net position with respect to the transferred assets. These two methods provide flexibility and minimise compliance costs for such entities.

1.35 An entity must make a choice for the form of the roll-over that is to apply to its CGT assets and revenue assets. *[Schedule #, Part 2, item 8, subsection 310-50(1)]*

1.36 In respect of CGT assets, an entity can choose either the global asset approach or individual asset approach to transfer its CGT assets. However, only one method can be chosen in respect to the transferred CGT assets. Specifically, an entity cannot use the individual asset approach in relation to some of the transferred assets and the global asset approach in relation to the remaining transferred assets. *[Schedule #, Part 2, item 8, subsection 310-50(2)]*

1.37 Similarly, an entity can choose either the global asset approach or individual asset approach to transfer its revenue assets. However, only one method can be chosen in respect to the transferred revenue assets. Specifically, an entity cannot use the individual asset approach in relation to some of the transferred assets and the global asset approach in relation to the remaining transferred assets. *[Schedule #, Part 2, item 8, subsection 310-50(3)]*

1.38 The entity choosing the form of the roll-over may choose different forms of roll-over for its CGT assets and revenue assets.

#### ***Consequences for CGT assets – individual asset approach***

1.39 Under this approach, the transferring entity may disregard all capital gains or losses it realises, or it may choose to disregard some or none of its capital gains or losses. The choice as to what gains or losses to disregard is a matter for the transferring entity. *[Schedule #, Part 2, item 10 and 12]*

1.40 A transferring entity that chooses the individual asset approach for its CGT assets may elect to treat those assets subject to the asset roll-

over as being transferred (or disposed of) to the receiving entity by treating:

- the assets that would otherwise realise a capital gain as being transferred at their cost base; and
- the assets that would otherwise realise a capital loss as being transferred at their reduced cost base.

1.41 The effect of the individual asset approach is that the transferred CGT assets will have neither a capital gain nor a capital loss on their transfer.

1.42 For the receiving entity, the first element of the cost base and reduced cost base of the transferred assets in its hands is taken to be equal to the cost base and the reduced cost base respectively of the asset just before its transfer (when it was still held by the transferring entity).  
*[Schedule #, Part 2, item 13]*

#### ***Consequences for revenue assets – individual asset approach***

1.43 Under this approach, the transferring entity may disregard all revenues gains or losses it realises, or it may choose to disregard some or none of its revenue gains or losses. The choice as to what gains or losses to disregard is a matter for the transferring entity. *[Schedule #, Part 2, item 15]*

1.44 This approach for revenue assets will treat the transferring entity's gross proceeds for the transfer of each revenue asset to be the amount, the deemed proceeds, it would need to have received to have no profit or loss from the transfer. This rule means that there is no gain or loss for the transferring entity.

1.45 The receiving entity will be taken to have paid an amount equal to the deemed proceeds for the transferring entity for each revenue asset received.

### **Application and transitional provisions**

1.46 The amendments apply in relation to all transfer events that happen during the period starting on 1 October 2011 and ending at the end of 1 July 2017. *[Schedule #, Part 3, item 17]*

## **Repeals and savings provisions**

1.47 These amendments end on 1 July 2017. The automatic repeal provision has been updated to reflect a repeal date of 1 July 2019. The repeal will occur two years after the end date of the legislation. [*Schedule #, Part 1, item 1*]

1.48 These amendments will operate for a limited time and will then be automatically repealed.

## **STATEMENT OF COMPATIBILITY WITH HUMAN RIGHTS**

### **Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011***

#### ***Taxation relief for merging superannuation funds***

1.49 This Schedule is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

#### **Overview**

1.50 This Schedule amends the ITAA 1997 and *Tax Laws Amendment (2009 Measures No. 6) Act 2010* to provide taxation relief to merging superannuation funds through the provision of loss relief and an asset roll-over.

#### **Human rights implications**

1.51 This Schedule does not engage any of the applicable rights or freedoms.

#### **Conclusion**

1.52 This Schedule is compatible with human rights as it does not raise any human rights issues.