The Senate

# Economics
# Legislation Committee

## Tax Laws Amendment (2009 Measures No. 6) Bill 2009 [Provisions]

February 2010

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# Senate Economics Legislation Committee

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**As the limited roll-over relief to be introduced by Subdivision 126-G is adequately broad, the Committee recommends the Senate pass Schedule 1 without amendment.**

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**Recommendation 3**

**After consideration of the proposed operation of the amendments and the government's policy intent, the committee recommends the Senate pass Schedule 3 without amendment.**

**Recommendation 4**

**The committee recommends the Senate pass Schedule 4 without amendment.**

**Recommendation 5**

**The committee recommends the Senate pass Schedule 5 without amendment.**

**Recommendation 6**

**After consideration of the proposed amendment, the committee recommends the Senate pass Schedule 6 without amendment.**

# Chapter 1

# Introduction

## Background

1.1 On 26 November 2009 the Senate Selection of Bills Committee referred the provisions of the *Tax Laws Amendment (2009 Measures No. 6) Bill 2009* to the Economics Legislation Committee for inquiry and report by 25 February 2010.[1]

1.2 The six schedules of the omnibus bill will amend various taxation laws to finalise a number of issues prior to the Government's consideration of the recommendations that flow out of Australia's Future Tax System (the Henry Review).[2]

1.3 The revenue implications of the measures contained in the bill vary; overall, the impact is expected to be small. Only Schedule 1 – capital gains tax trust cloning and limited fixed trust roll-over is expected to have a positive revenue impact.[3]

## Conduct of the inquiry

1.4 The committee advertised the inquiry in the national press and contacted a number of organisations inviting submissions to be lodged by 18 December 2009. Ten submissions were received, the majority of comment concentrated on Schedule 2 (loss relief for merging superannuation funds) of the bill.

1.5 The committee would like to thank all those who contributed to the inquiry.

## Structure of the report

1.6 Chapter 2 outlines the provisions of Schedule 1 to the bill, explains how they will operate and analyses the impacts of the changes. Similarly, Chapter 3 details the intricacies of Schedule 2.

1.7 Chapter 4 sets out and analyses the remaining Schedules 3 to 6 of the bill.

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1 Selection of Bills Committee, Report No. 18 of 2009, 26 November 2009. Appendix 5.

2 The Hon. Dr Craig Emerson MP, Second Reading Speech, *House of Representatives Hansard*, Wednesday 25 November 2009, p. 6.

3 Tax Laws Amendment (2009 Measures No. 6) Bill 2009, Explanatory Memorandum, pp 7 – 10.

# Chapter 2

# Schedule 1 – Removal of capital gains tax trust cloning exception and provision of limited fixed trust roll-over

## Introduction

2.1 This chapter explains the changes proposed in Schedule 1, outlining their operation and impacts.

## Schedule 1 – Trust cloning and roll over relief

2.2 The amendments of Schedule 1 apply to capital gains tax (CGT) events happening on or after 1 November 2008.[1]

2.3 An entity can only make a capital gain or loss if a CGT event takes place in the income year. A CGT event generally occurs where certain classes of assets (CGT assets) are sold, transferred or otherwise 'disposed'.

2.4 There are many special rules and exceptions which operate to modify the CGT law. To assist with the application of this area of taxation law, section 104-5 of the *Income Tax Assessment Act 1997* (ITAA 1997) provides an exhaustive list of those circumstances where a CGT event occurs and outlines what the CGT implications in the circumstances will be.

2.5 Schedule 1 of this bill deals specifically with the abolition of the exception known as 'trust cloning'[2] which affects the operations of CGT events E1 (the situation of a trust being created over a CGT asset) and E2 (a CGT asset being transferred to a trust).

2.6 Under the current legislative framework, where a trust is created over a CGT asset or a CGT asset is transferred to a trust, CGT events E1 and/or E2 are triggered to ensure that the loss or gain arising from the transaction will be taxed appropriately. This rule however is modified by the operation of the 'trust cloning' exception.

2.7 The trust cloning exception, currently contained in subsections 104-55(5) and 104-60(5) of the ITAA 1997, operates to deem that CGT events E1 and/or E2 do not occur, if, in the situation of a trust being created over a CGT asset (E1) the taxpayer is the sole beneficiary of the trust, is absolutely entitled to the asset and the trust is not a

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1 Explanatory Memorandum, Tax Laws Amendment (2009 Measures No. 6) Bill 2009, para 1.107, p. 37.

2 These provisions are referred to as the 'trust cloning' exceptions as there is no change in the beneficiaries and there is no difference in the terms of the trusts.

unit trust[3]; or in the case of a CGT asset being transferred to a trust (E2), the asset is transferred from another trust and the beneficiaries and terms of both trusts are the same.[4]

2.8 Schedule 1 of this bill will repeal these subsections thereby removing the concessional treatment and tightening its operation. This change is designed to align the taxation of trust restructures with the policy principle of taxing capital gains where there is a change in ownership of an asset.[5]

2.9 In some circumstances CGT 'roll-over relief' will be provided where although there is a change in legal ownership there is no change in the underlying ownership.[6] This relief will be provided through the introduction of subdivision 126-G.[7] Subdivision 126-G will have the effect of deferring the making of any capital gain or loss associated with events E1 and/or E2.

2.10 An exception will be introduced to ensure that CGT events E1 and/or E2 do not arise where there is a change in the person holding the office of trustee given that the trust remains the same entity regardless of any such change.[8]

### *Eligibility*

2.11 To be eligible to access roll-over relief, both trusts must have the same beneficiaries with the same entitlements and terms. The terms of the trusts must also be similar and although they are not required to be exactly the same, they must not contain terms or discretionary powers that would cause different results for the beneficiaries.[9] At the same time the receiving trust is required to be a newly created trust or a trust without any CGT assets other than a small amount of cash or debt – ie an 'empty trust'.[10]

2.12 Roll-over relief will generally be applied on an asset-by-asset basis although relief can be sought for the transfer of multiple assets transferred as part of an arrangement.[11]

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3 Subsection 104-55(5) of the ITAA 1997.

4 Subsection 104-60(5) of the ITAA 1997.

5 Explanatory Memorandum, p. 11.

6 Explanatory Memorandum, p. 12.

7 New subdivision 126-G will be titled 'Transfers of assets between certain trusts'. (Division 126 of which subdivision 126-G will be a part, is titled 'Same asset roll-overs'.)

8 Explanatory Memorandum, paras 1.18 – 1.19, p. 14.

9 Explanatory Memorandum, para 1.31, p.17, para 1.27 p. 16 and p. 12.

10 Explanatory Memorandum, pp 12, 16.

11 Explanatory Memorandum, paras 1.66 – 1.68, p. 26.

### *Exceptions to roll-over relief*

2.13 The CGT roll-over relief being introduced by subdivision 126-G will not be available in all situations of asset transfer. Roll-over relief will not be available where:

(a) the receiving trust is a foreign trust for CGT purposes and the asset transferred is not taxable Australian property;[12]

(b) the trusts involved are taxed like companies or were at any time during the year that the transfer took place, either a corporate unit trust or a public trading trust;[13] and

(c) in instances where both trusts have not made the same elections ('mirror choices') and the absence[14] of a 'mirror choice' in the other trust will have an ongoing and material impact on the entity's net or taxable income.[15]

### *Consequences of roll-over relief*

*Trustees*

2.14 In situations where both the trustee of the transferring trust and the trustee of the receiving trust elect roll-over relief, any capital gain or loss made by the transferring trustee in respect of the transferred asset is disregarded.[16] As a result of electing roll-over relief the cost base and reduced cost base of the asset will take the value that it held while in the hands of the transferring trustee just before the transfer time.[17]

2.15 The time of acquisition will also be affected and in all circumstances, except those involving pre-CGT assets, the receiving trust will be taken to acquire the asset at the time the asset is transferred or the trust over the asset is created.[18]

2.16 In those circumstances where the transferred asset was acquired prior to the introduction of the CGT regime (pre 20 September 1985), the transferred asset will be taken to have been acquired by the receiving trust prior to 20 September 1985.[19]

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12 Explanatory Memorandum, para 1.51, p. 22.

13 Explanatory Memorandum, para 1.52, p. 23.

14 Generally, the 'mirror choice' is required to be in force just after the transfer time - Explanatory Memorandum, para 1.56, p. 24.

15 Explanatory Memorandum, paras 1.53 – 1.55, p. 23.

16 Explanatory Memorandum, para 1.74, p. 28.

17 Explanatory Memorandum, para 1.75, p. 28.

18 Explanatory Memorandum, para 1.77, p. 28.

19 Explanatory Memorandum, para 1.76, p. 28.

2.17 As a result of electing roll-over relief, the receiving trust will be required to forfeit any net capital losses attributable to prior years which they have carried forward.[20]

*Beneficiaries*

2.18 Like the trustees of the transferring and receiving trusts, after roll-over is elected, the beneficiaries are also required to adjust the cost base and reduced cost base of their interests in each trust on an interest-by-interest basis.[21]

2.19 The date of acquisition of their interests in the receiving trust is deemed to be the transfer time. Again, the only exception is where the interests that are transferred were acquired by the transferring fund prior to 20 September 1985. In this case the beneficiaries will also be deemed to have received their interests prior to 20 September 1985.[22]

2.20 The bill also provides special rules in situations where CGT discounts are required to be calculated.[23]

***Requirement to give information***

2.21 New subdivision 126-G introduces a notification requirement that will require the trustee of the transferring trust to send written notice containing certain information to each of the beneficiaries following the transfer of the interests.[24] In those instances where there are two or more trustees, each trustee is liable to provide written notice to the beneficiaries although the obligation can be satisfied by any one of the trustees.[25]

2.22 Proposed subsection 126-260(2) specifies that written notice must set out:

- the transfer time;
- the market value of each of the beneficiaries' membership interests in the transferring trust both just before and just after the transfer time; and
- information to enable the beneficiaries to work out which interests in the receiving trust correspond to their interests in the transferring trust.[26]

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20 Explanatory Memorandum, paras 1.78 – 1.80, p. 29.

21 Explanatory Memorandum, para 1.86. p. 30.

22 Explanatory Memorandum, paras 1.95 – 1.96, pp 33 – 34.

23 To calculate any CGT discount, the ownership period of the beneficiary's membership interests in the receiving trust will include the period of ownership of the member's interests in the transferring trust. Explanatory Memorandum, para 1.97, p. 34.

24 Explanatory Memorandum, para 1.101, p. 36.

25 Explanatory Memorandum, para 1.104, p. 37.

26 Explanatory Memorandum, para 1.102, p. 36.

2.23 The bill provides that where the requirement to give notice is not met the trustee commits an offence.

2.24 Failure to give notice will not relieve the beneficiaries of their obligation to make the necessary adjustments to the cost base and reduced cost base of their interests.[27]

### *Transitional provisions*

2.25 Given the retrospectivity of Schedule 1, the bill proposes the introduction of transitional provisions to ensure that trustees will have adequate time to make the mirror choices required by subsection 126-235(3) and provide the beneficiaries with written notification pursuant to section 126-260.[28] A period of six months from Royal Assent for this transitional period is proposed.

## Views on Schedule 1

2.26 As explained in paragraph 2.9, the proposed changes are designed to ensure that the CGT provisions of the income tax law operate in accordance with the principle of taxing capital gains that arise where there is a change in ownership.[29] The changes are being introduced as an integrity measure to ensure that trust cloning is not used inappropriately to avoid taxation.

2.27 After the proposal was first announced on 31 October 2008,[30] the Treasury undertook extensive public consultation during both the policy design and the exposure draft stages.

2.28 The majority of comment received during that period was critical of the changes, opposing them on the basis that there are legitimate reasons for trust cloning and suggesting instead that the government address any uncertainty or integrity concerns with the operation of the existing provisions directly.[31]

2.29 The various concerns that were raised during the consultation process were, in most cases, discounted. However the draft legislation was amended prior to its introduction into the House of Representatives on 25 November 2009 in recognition that there will be some situations where it will be appropriate to provide relief from

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27 Explanatory Memorandum, paras 1.103 – 1.106, p. 37.

28 Explanatory Memorandum, paras 1.108 – 1.109, pp 37 – 38.

29 The Hon. Chris Bowen MP, Government abolishes trust cloning tax concession, Media release No. 092, 31 October 2008.

30 The Hon. Chris Bowen MP, Government abolishes trust cloning tax concession, Media release No. 092, 31 October 2008.

31 Australian Government, Department of the Treasury, *Abolishing the capital gains tax (CGT) trust cloning exception and providing a roll-over for fixed trusts, Summary of Consultation Process*, December 2009.

CGT where assets are transferred between certain trusts. As a result, the bill now provides for limited roll-over relief through proposed Subdivision 126-G, its effect being to ensure that any CGT consequences that arise as a result of a transfer are deferred.[32]

2.30 Subdivision 126-G will identify those instances where roll-over relief is available and the consequences of electing to access that option.

### *The current inquiry*

2.31 In conducting its inquiry into TLAB 6 the committee received 10 submissions. Of those, only one made mention of the changes proposed by Schedule 1 detailing the concern that they will not achieve the policy intent being sought and suggesting that the operation of the amendments and the application of the proposed roll-over relief will be far too narrow.[33]

2.32 The submission was critical of the criteria that will be introduced and required to be met to enable a trust to qualify for the relief and suggested a number of changes be made to widen access to what will be the new Subdivision 126-G.[34]

*Committee view*

2.33 The committee notes that the purpose of the amendments is to ensure that CGT considerations do not excessively interfere with decisions concerning trust restructures yet at the same time ensures that the parties involved are taxed appropriately.[35] The committee takes the view that it is appropriate to limit roll-over relief in situations of restructure to ensure restructuring is not principally used as a mechanism for avoiding tax.

2.34 The committee acknowledges that the proposed amendments will tighten the existing legislative provisions resulting in instances where a CGT liability that would not have arisen due to the trust cloning exceptions will be incurred. As the proposed change is an integrity measure it is considered appropriate that the law be modified to

32 The Hon. Chris Bowen MP, Assistant Treasurer and Minister for Competition Policy and Consumer Affairs, Government acts to reduce compliance costs and improve the tax law (Attachment F), Media Release No. 048, 12 May 2009.

33 Blake Dawson, *Submission 3*, 18 December 2009, pp 1 – 2.

34 Blake Dawson, *Submission 3*, 18 December 2009, p. 3.

35 Explanatory Memorandum, p. 15.

tighten access to concessional taxation treatment where its operation has revealed such a need.[36]

**Recommendation 1**

**As the limited roll-over relief to be introduced by Subdivision 126-G is adequately broad, the Committee recommends the Senate pass Schedule 1 without amendment.**

36 The need to tighten the trust cloning exception to CGT events E1 and E2 was acknowledged by the accounting industry who, in their submission to Treasury advised that they considered it too wide and needing to be narrowed to protect the CGT base. Source: The Institute of Chartered Accountants in Australia, *Submission to the Treasury on exposure draft – abolishing the capital gains tax trust cloning exception and providing a roll-over relief for fixed trusts*, 6 October 2009, Appendix 1, p. 4.

# Chapter 3

## Schedule 2 – Loss relief for merging superannuation funds

### Overview

3.1 Schedule 2 of the bill proposes amendments that will facilitate mergers of complying superannuation funds by allowing the roll-over of capital losses and the transfer of revenue losses.[1]

3.2 Under the existing legislative framework, the transfer of assets from a 'closing' fund to a continuing fund, as a result of a merger, triggers a CGT event and gives rise to a CGT loss or gain for the transferring fund.[2] In these circumstances, any losses accumulated by the transferring superannuation fund are extinguished on the fund's wind up.

3.3 This particular feature of the law currently operates to reduce the value of the members' benefits and thus presents a barrier to consolidation and restructuring within the superannuation industry.[3] It is this aspect of the ITAA 1997 which Schedule 2 seeks to address.

3.4 Schedule 2 proposes amendments that will modify the existing provisions to introduce optional CGT roll over relief. It will do this through the introduction of new Division 310.

### Introduction of a new Division - Division 310

3.5 The Explanatory Memorandum to the bill identifies that the need to facilitate superannuation fund consolidation was recognised during the volatility in the global economy and financial markets further explaining that:

> it is important that potential barriers to a robust and efficient superannuation industry are minimised…to enhance the efficiency and robustness of the superannuation system in response to these uncertainties.[4]

3.6 As a result, the bill proposes amendments that provide two alternative options for funds seeking loss relief when pursuing a merger: (1) loss transfer; and (2) asset roll-over. These provisions will be contained in Subdivisions 310-B and 310-D.

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1 Explanatory Memorandum, para 2.1, p. 39.

2 Explanatory Memorandum, para 2.3, p. 39.

3 Capital gains that arise as a result of mergers do not have the same negative impact on the value of the members' benefits as they are not extinguished and therefore do not present the same challenges to mergers. Explanatory Memorandum, para 2.9, p. 40.

4 Explanatory Memorandum, para 2.8, p. 40.

3.7 Subdivision 310-A details the objective of the Division stating at section 310-5 that:

> The main object of th[e] Division is to facilitate the consolidation of the superannuation industry by allowing certain merging superannuation funds to retain the value, for income tax purposes, of certain losses that might otherwise cease to be able to be utilised as a result of the merger.[5]

3.8 These changes were first announced by the government on 23 December 2008. Following that announcement, the Treasury undertook public consultation prior to releasing an exposure draft for comment.

3.9 Throughout the consultation process and during the current inquiry, the superannuation industry has been supportive of the relief that will be offered through the proposed changes.

> We fully support the Government's proposals to provide rollover relief for merging superannuation funds.[6]
>
> We welcome the proposed relief and believe the provisions of the Bill should be passed in its current form as it should lead to greater efficiencies for superannuation funds, and deliver better retirement savings outcomes for fund members.[7]
>
> AXA is supportive of the proposal to provide Capital Gains Tax Rollover relief to superannuation funds that are merging.[8]
>
> ASFA is strongly supportive of this initiative by the Government, which seeks to address an issue critically affecting certain funds in the superannuation industry in the present financial climate.[9]

3.10 The bill incorporates feedback received during the consultation process that will ensure the law operates in accordance with the underlying policy intent.[10]

## Date of effect

3.11 Should Royal Assent be received, the amendments will operate to apply to CGT events that occur on or after 24 December 2008 and before 1 July 2011.[11]

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5 Tax Laws Amendment (2009 Measures No. 6) Bill 2009, item 3, p. 21.

6 Mercer (Australia) Pty Ltd, *Submission 2*, p. 1.

7 ING, *Submission 5*, p.1.

8 AXA Australia, *Submission 7*, p. 1.

9 The Association of Superannuation Funds of Australia Limited (ASFA), *Submission 8*, p. 1.

10 Australian Government, The Treasury, *Loss relief for superannuation funds that merge – Summary of consultation process*, 2009, p. 1.

11 Explanatory Memorandum, para 2.113, p. 65.

3.12 The government has limited the operation of the proposed law to this period but at the same time have given an undertaking that the situation would be revisited following the completion of the Australia's Future Tax System Review (the Henry Review) which is also examining the taxation of capital gains.[12]

3.13 This feature of the proposed law created much comment during the consultation period and during the current inquiry.

3.14 Following initial policy consultation after the measure's announcement in late 2008, the expiry date of the measure was extended from 30 June 2010 to 30 June 2011.[13] The limited application of the measure has continued to cause consternation during the inquiry process, and was raised in a number of submissions as being a potential impediment to the measure's effectiveness.

3.15 The concern of the funds relates to the complicated processes involved in a merger transaction, particularly in the case of large funds. Submitters contend that the arbitrary date of 30 June 2011 may result in mergers being abandoned at the last moment if they cannot be finalised by that date.[14]

3.16 AXA Australia suggested that the transfer of assets in the case of a merger of two or more superannuation funds should be excluded from the definition of a CGT event.[15]

*Committee view*

3.17 The committee takes the view that AXA's proposal would go too far and potentially encourage merger for purposes other than efficiency and consolidation. The committee considers the point raised in relation to the complexity of merger transactions and therefore the potential difficulty and expense that could be incurred should merger transactions not be finalised due to a mere timing issue is potentially problematic. However the committee notes the extensive consultation process already undertaken and the extension of the measure by twelve months to 30 June 2011 has provided the industry with substantial notice. The committee therefore expect that the Minister and Treasury will monitor this situation and address these concerns if a merger looks as though it may be abandoned due to the cut off date.

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12 Senator The Hon. Nick Sherry, Minister for Superannuation and Corporate Law, Optional CGT loss roll over for complying super funds, Media Release 23 December 2008.

13 Australian Government, The Treasury, *Loss relief for superannuation funds that merge – Summary of consultation process*, 2009, p. 1.

14 Mercer, *Submission 2*, p. 2.

15 AXA Australia, *Submission 7*, p. 4.

## Choosing roll-over relief

3.18 Division 310 will identify the conditions that must be met for the trustee of a complying superannuation fund or approved deposit fund[16] (ADF) to be eligible to choose the optional loss transfer or asset roll-over relief when arranging to merge complying superannuation funds.[17]

3.19 The transferring superannuation fund's satisfaction of these eligibility conditions however does not of itself authorise the merger or transfer; the trustees are also required to consider the governing trust deeds and legislation.[18]

3.20 Where the criteria are satisfied, an eligible entity with an arrangement to merge superannuation funds may choose a loss transfer, an asset roll-over or a combination of loss transfer and asset roll-over; their choice dependent on their circumstances and the legislative conditions attached to the choices.[19]

3.21 It is noted that an entity's election will be reflected in its annual income tax return and no additional notification requirement will be introduced.[20]

## Subdivision 310-B – Choosing to transfer losses

3.22 The conditions that must be satisfied to enable complying superannuation funds and ADFs to elect to transfer losses differ depending on the asset types held by the transferring fund.[21] Subdivision 310-B identifies the three asset types that may be held by a fund and provides the conditions that are required to be satisfied in each of these circumstances.

### *Conditions for funds directly holding assets*

3.23 Proposed section 310-10 (Original fund's assets extend beyond life insurance policies and units in pooled superannuation trusts) applies to funds that directly hold their assets.

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16 Approved deposit fund is defined in section 10 of the SIS Act as meaning 'a fund that : (a) is an indefinitely continuing fund; and (b) is maintained by an RSE licensee that is a constitutional corporation; and (c) is maintained solely for approved purposes.' A registrable superannuation entity (RSE) licensee means a regulated superannuation fund, or an approved deposit fund, or a pooled superannuation trust, but does NOT include a self managed superannuation fund (SMSF).

17 Explanatory Memorandum, para 2.13, p. 42.

18 Explanatory Memorandum, para 2.14, p. 42.

19 Explanatory Memorandum, para 2.16, p. 42.

20 Explanatory Memorandum, p. 64.

21 Explanatory Memorandum, p. 43.

3.24 The explanatory memorandum explains that loss transfer will be available to eligible funds that directly hold assets provided the following conditions are satisfied:

(a) the transferring fund holds assets just before the merger arrangement;

(b) the transferring fund ceases to have any members and the individuals who cease to be members of the transferring fund become members of the continuing fund;[22] and

(c) the continuing fund is not a small superannuation fund.[23]

3.25 Although the explanation contained in the explanatory memorandum is clear, the words of the proposed provision confuse its application as they employ conflicting terms in the heading and the subsection.

3.26 More specifically, the section heading refers to the original fund's assets **extending beyond** life insurance policies and units in a pooled superannuation trust (PST). This contrasts with the words of subsection 310-10(2) which provide that the transferring entity's assets include assets **other than** a complying superannuation life insurance policy or units in a PST.

3.27 Submissions received also questioned this aspect of the bill raising the concern that it appears contradictory and creates ambiguity.[24]

**Recommendation 2**

**Given the apparent conflict between the words of the explanatory memorandum which refer to directly held assets and the terminology used in the bill, the committee suggests that the words of the bill be amended and that the heading of section 310-10 be changed to reflect that the section applies in instances where the fund involved in the merger directly holds assets.**

***Conditions for funds that hold life insurance policies as assets***

3.28 Proposed section 310-15 outlines the conditions that must be satisfied to enable a fund, the assets of which include a life insurance policy, to access loss relief as a part of the merger arrangement.

3.29 In these circumstances, the transferring fund may either transfer the policy to the continuing fund or request that the insurance company transfer the value of the

22 There will be limited exceptions to this to cover those circumstances where members cannot be transferred to the continuing fund. Explanatory Memorandum, paras 2.24 – 2.25, p. 44.

23 This requires that a continuing fund have at least five members. As a result the continuing fund cannot be an SMSF or a small APRA fund (refer to EM paras 2.27 – 2.31, p. 46). This condition is consistent with the policy intent of the measure to enable consolidation within the superannuation industry.

24 Deloitte Touche Tohmatsu Ltd, *Submission 4*, pp 1 – 2.

assets that support the policy to the continuing fund, a PST,[25] or another insurance company.[26]

3.30 Like funds that directly hold assets, the transferring and continuing fund in these circumstances are also required to comply with the requirements that the members of the transferring fund cease to be members of that fund and become members of the continuing fund; and the continuing fund must not be a small superannuation fund.

3.31 In these circumstances it is the life insurance company and not the transferring fund that is able to access loss relief.[27] It is noted however, that section 118-300 of the ITAA 1997 ensures CGT relief is available to continuing funds where that fund incurs a capital gain or loss in relation to life insurance policies it holds as a result of a merger.[28]

### *Conditions for funds where assets include units in a PST*

3.32 Superannuation funds may use PSTs to hold investment assets indirectly. The use of PSTs enables a fund to allocate its assets between different investment types to reflect investor risk and investment preferences.[29]

3.33 Proposed section 310-20 sets out the conditions that must be satisfied by a fund where the fund assets include units in a PST to enable the fund to access loss relief when involved in a merger.

3.34 In these circumstances, where a fund that holds assets, including units in a PST, decides to merge with another fund, the transferring fund may choose to transfer its units in the PST to the continuing fund. Alternatively, the PST may transfer the assets to the continuing fund, another PST or a life insurance company.[30]

3.35 In these circumstances it is the trustee of the PST who is able to choose loss transfer relief provided the conditions concerning members and size of the continuing fund are satisfied. (It is noted that these conditions apply to all funds that elect to transfer losses regardless of how the fund holds its assets.)[31]

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25 A pooled superannuation trust (PST) is defined in section 48 of the *Superannuation Industry (Supervision) Act 1993* as: a unit trust, (a) the trustee of which is a constitutional corporation; and (b) that, under the regulations is a unit trust to which this definition applies.

26 Explanatory Memorandum, para 2.34, p. 47.

27 Tax Laws Amendment (2009 Measures No. 6) Bill 2009, proposed subsection 310-15(1).

28 Explanatory Memorandum, p. 47.

29 Explanatory Memorandum, para 2.39, p. 48.

30 Explanatory Memorandum, para 2.40, p. 48.

31 Proposed subsections 310-10(3), 310-10(4), 310-15(3), 310-15(4), 310-20(3) and 310-20(4) of Tax Laws Amendment (2009 Measures No. 6) Bill 2009 set out these requirements concerning members transferring to the continuing fund and the size of the continuing fund.

3.36 The transferring fund can access CGT relief through section 118-350 of the ITAA 1997.

## Subdivision 310-C – Consequences of choosing to transfer losses

3.37 Choosing to transfer losses under subdivision 310-B will enable a transferring fund to ensure that the losses that would otherwise be extinguished as a result of the merger are retained for use by the continuing fund. This has a positive impact on the value of the members' benefits.[32]

3.38 Where a transferring fund chooses to transfer losses, the losses can be transferred to one or more entities, including:

(a) the continuing fund;

(b) a PST in which the units are held by the continuing fund; and/or

(c) a life insurance company which has issued a complying superannuation or FHSA life insurance policy that is held by a continuing fund.[33]

3.39 Where a previously realised loss is transferred, it is taken not to have been made by the transferring entity but by the continuing entity in the income year in which it is transferred.[34] Where this occurs the continuing entity will be taken to have made an amount equal to the loss and the transferring entity will be required to reduce their transfer deductions by the same amount as the loss.[35]

## Subdivision 310-D – Choice for assets roll-over

3.40 The bill also proposes the introduction of subdivision 310-D which sets out that where a complying superannuation fund or ADF is eligible to elect to transfer losses pursuant to subdivision 310-B, that entity is also eligible to elect assets roll-over relief provided an additional three conditions are satisfied:[36]

(i) under the merger arrangement, one or more CGT events occur with the result that the transferring entity will no longer hold the original assets;

(ii) the transfer events must all occur in the transfer year – this ensures that roll-over relief is only available to entities that complete their merger within a single year and substantially reduces complexity; and

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32 Explanatory Memorandum, para 2.45, p. 48.

33 Explanatory Memorandum, para 2.46, p. 49.

34 Explanatory Memorandum, para 2.51, p. 50.

35 Explanatory Memorandum, para 2.55, p. 50.

36 It is noted that the Schedule 2 of the bill will include an amendment to ensure that roll-over involving depreciating assets automatically qualify for roll-over relief pursuant to section 40-340 of the ITAA 1997.

(iii) the CGT assets become assets of another complying superannuation fund, PST or life insurance company because they are no longer held by the transferring entity.[37]

3.41 The only exception to the requirement that the transferring entity cease holding all CGT assets arises in situations where the transferring entity retains assets to pay the debts and entitlements of members who cannot be transferred to the continuing fund.[38]

3.42 The detail of proposed subdivision 310-D caused in depth comment from submitters to the committee's inquiry.

***The term 'arrangement'***

3.43 Concern was raised as to the breadth of the term 'arrangement' in proposed section 310-45, particularly when referred to in proposed subsection 310-45(2) with reference to 'one or more CGT events'.[39]

3.44 In considering this matter, the committee had regard to the meaning of the terms used, their context and the explanatory memorandum.

3.45 Section 995-1 of the ITAA 1997 defines 'arrangement' as meaning 'any arrangement, agreement, understanding, promise or undertaking, whether express or implied, and whether or not enforceable (or intended to be enforceable) by legal proceedings.' This definition of arrangement, when used together with the words 'one or more CGT events' and considered in the context of the object of the Division is considered sufficiently broad as to encompass a vast range of methods that may be used to effect superannuation fund mergers. Indeed, the committee notes that paragraph 2.13 of the explanatory memorandum provides that:

> [t]he broad term 'arrangement' is used in these provisions as it is not intended to limit the manner in which superannuation entities may merge.[40]

*Committee view*

3.46 In light of the reference to one or more CGT events, considering that the ITAA 1997 specifically identifies all CGT events that are capable of occurring in Division 104 and proposed subsection 310-45(2) does not propose to limit those that can be used apart from requiring the result of the event be that the transferring entity ceases to own the asset, the committee is confident that the concerns raised are adequately addressed in the bill.

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37 Explanatory Memorandum, paras 2.62 – 2.67, pp 51 – 53.

38 Explanatory Memorandum, para 2.69, p. 54.

39 Mallesons Stephen Jaques, *Submission 9*, p. 2.

40 Explanatory Memorandum, para 2.13, p. 42.

*The requirement that all transfer events occur in the transfer year*

3.47 Proposed section 310-45 will also require that where a fund seeks to access assets roll-over, all the transfer events are required to occur within the transfer year. Submissions received commented that the requirement that all such events be finalised within a year may hinder the effectiveness of the provisions and increase administrative costs for the funds involved.[41]

3.48 Although the submissions have raised these potential problems, the committee notes that the requirement for transfer events to occur within the one year was included to avoid complexity and following Treasury consultation which provided anecdotal evidence that it should not be difficult for merger arrangements 'to satisfy the single year requirement'.[42]

## Subdivision 310-E – Consequences of asset roll-over

3.49 The bill will introduce two methods for effecting asset roll-over, the method available dependant on the net capital loss position of the transferring entity in respect of its transferred assets.[43]

(i) the global asset approach; and

(ii) the individual asset approach.

3.50 Transferring entities in a net capital loss position are eligible to elect either of the two approaches. The approach elected however is required to be used for all of the entity's transferred assets.

3.51 A transferring entity that is not in a net capital loss position is only eligible to apply the individual asset approach to implement its asset roll-overs.[44]

### *The global approach*

3.52 Under the global asset approach, the assets being transferred to the continuing entity that would otherwise realise a capital gain are treated as being transferred at their cost base and those that would realise a capital loss are treated as being transferred at their reduced cost base.[45]

3.53 In circumstances where revenue assets are being transferred under the global approach, the transferring fund is deemed to have received the amount that would be

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41 ASFA, Submission 8, pp 1 – 2. Mercer, *Submission 2*, p. 2.

42 Australian Government, The Treasury, *Loss relief for superannuation funds that merge – Summary of consultation process*, 2009, p. 2.

43 Explanatory Memorandum, p. 56.

44 Explanatory Memorandum, paras 2.81 – 2.82, p. 56.

45 Explanatory Memorandum, p. 57.

needed to ensure there is no profit or loss in relation to the transferred asset and the continuing fund will be deemed to have paid an amount equal to those deemed proceeds.[46]

3.54 This ensures that the transfer of the assets does not give rise to a CGT loss or CGT gain.[47]

***The individual asset approach***

3.55 The individual asset approach provides for the transferring fund to disregard either all, some or none of the capital losses it realises on transfer.[48] The capital gains it realises on transfer however are not disregarded.[49]

3.56 Under this approach, the capital proceeds that are received on the transfer of the assets to the continuing fund and which are being rolled-over to the continuing entity take the value of the asset's reduced cost base when the asset was held by the transferring fund.[50]

3.57 The application of the individual asset approach to the roll-over of revenue assets does slightly differ: where a revenue asset is being rolled-over in accordance with the individual asset approach, any tax loss that arises from the transfer may be disregarded by the transferring entity and its proceeds deemed not to have been of an amount that would result in a profit or loss. At the same time, the continuing entity will be deemed to have paid the same amount that the transferring entity was deemed to have received.[51]

3.58 A consequential amendment to section 115-30 of the ITAA 1997 (dealing with special rules about acquisition) will ensure that the 12 month ownership requirement that enables a CGT discount will not be subverted by an asset roll-over. This will be achieved through identifying in section 115-30 that the 12 month ownership period for assets acquired under a roll-over commences from the date the asset was acquired by the transferring fund.[52]

3.59 The fact that proposed subdivision 310-E only provides for relief in situations of net capital loss did attract comment, critics of the view that relief should also be available to merging funds where the transfer results in a net gain. This view was expressed on the basis that given the uncertainty involved in the superannuation

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46 Explanatory Memorandum, paras 2.96 – 2.97, p. 61.

47 Explanatory Memorandum, p. 57.

48 Explanatory Memorandum, para 2.88, p. 58.

49 Explanatory Memorandum, para 2.88, p. 58.

50 Explanatory Memorandum, para 2.89, p. 58.

51 Explanatory Memorandum, paras 2.99 - 2.100, p. 62.

52 Explanatory Memorandum, p. 66.

industry (given the role of the financial markets) and the need to determine the net capital gain or loss position just before the transfer takes place.[53]

3.60 Submissions contended that use of the phrase 'just before the event' in proposed subdivision 310-E could result in uncertainty and cause funds to abort mergers at the last minute should unexpected changes result in a net capital gain position.

3.61 To alleviate this potential problem, the suggestion was made that an arbitrary point in time be chosen, for example, three months prior to the transfer, as the date on which the net capital gain or loss of the transferring entity is determined.

3.62 Under both the global approach and the individual asset approach, the cost base and reduced cost base of the assets when transferred to the continuing fund are given the value of the cost base and reduced cost base of the assets at the time just before the transfer.[54]

*Committee view*

3.63 The committee does not support the suggestion to introduce an arbitrary point in time at which merging funds establish their net capital gain or loss. The committee feels that this would not alleviate the uncertainty associated with the superannuation industry due to financial markets and that it is appropriate that this assessment occur just before the transfer takes place.

## Consequential amendments

3.64 A number of additional and consequential amendments will be made to give effect to Division 310.

3.65 In particular an additional amendment will be made to ensure the optional CGT relief that these amendments introduce will be automatically repealed two years after the end of their effective life, ie two years after 20 June 2011.[55]

*Committee view*

3.66 The committee supports the consequential amendments.

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53 AXA Australia, *Submission 7*, pp 5 – 6.

54 Explanatory Memorandum, pp 57, 60.

55 Tax Laws Amendment (2009 Measures No. 6) Bill 2009, item 3, p. 2.

# Chapter 4

# The remaining schedules of the bill

## Schedule 3 – Exempt annuity business of life insurance companies

4.1 The amendments proposed in Schedule 3 of the bill are intended to clarify the operation of the existing law.

4.2 The need for these amendments arose as a result of the transfer of the provisions from the ITAA 1936 to the ITAA 1997 and subsequent changes that were made under the Simplified Superannuation amendments in 2007-08. These events have raised questions about the interpretation of the provisions.[1]

4.3 The proposed changes will ensure that the law clearly identifies those situations where annuity income[2] derived by life insurance companies will be classified as non-assessable non-exempt income.[3]

4.4 The explanatory memorandum to the bill explains that the income derived by life insurance companies from immediate annuity business should be exempt from tax to prevent double taxation given that the policy holder of the annuity will be taxed on any annuity income they receive.[4]

4.5 The changes proposed by Schedule 3 are designed to operate retrospectively:

- the amendments retrospective to 1 July 2000 are designed to correct the provisions that were drafted to update and replace those of the ITAA 1936 to ensure that they operate consistently with the former provisions;[5] and

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1 Explanatory Memorandum, p. 67.

2 According to section 995-1 of the ITAA 1997, the term annuity is defined as including an annuity within the meaning of the *Superannuation Industry (Supervision) Act 1993* (the SISA defines annuity as including a benefit provided by a life insurance company or registered organisation); or a pension, within the meaning of the *Retirement Saving Accounts Act 1997.*

3 Non-assessable non-exempt income is defined in section 6-23 of the ITAA 1997 as being: an amount of ordinary or statutory income that this Act or another Commonwealth law states is not assessable income and it is not exempt income.

4 Explanatory Memorandum, para 3.3, p. 67.

5 Explanatory Memorandum, p. 68.

- the amendments retrospective to 1 July 2007 will ensure that the annuity conditions[6] do not apply to annuity policies that are superannuation income streams.[7]

***Views on Schedule 3 – exempt annuity business***

4.6 Division 320 of the ITAA 1997 specifies the tax treatment of life insurance companies containing provisions to ensure that their tax treatment is comparable to that of other providers of superannuation income streams.

4.7 The changes proposed by Schedule 3 of the bill propose amendments to subdivision 320-H (Segregation of assets to discharge exempt life insurance policy liabilities) designed to ensure:

(i) that the non-assessable non-exempt income of life insurance companies includes income from assets supporting immediate annuity policies; and

(ii) that the annuity conditions will not apply to immediate annuity policies of life insurance companies where those annuities are superannuation streams.[8]

4.8 These changes were announced by the Assistant Treasurer and Minister for Competition and Consumer Affairs, the Hon. Chris Bowen MP, on 12 May 2009.[9]

4.9 None of the ten submissions mentioned the amendments proposed by Schedule 3.

**Recommendation 3**

**After consideration of the proposed operation of the amendments and the government's policy intent, the committee recommends the Senate pass Schedule 3 without amendment.**

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6 Annuity conditions are designed to prevent excessive deferral of tax on income derived by life insurance companies that relate to immediate annuity policies – Explanatory Memorandum, para 3.26, p. 72.

7 The Hon Chris Bowen MP, Assistant Treasurer and Minister for Competition Policy and Consumer Affairs, Media Release No. 092, 31 October 2008.

8 Treasury Discussion Paper, Life insurance companies: Exempt life insurance policies, 2009, p. 1.

9 Treasury Discussion Paper, Life insurance companies: Exempt life insurance policies, 2009, p. 1.

## Schedule 4 – Deductible gift recipients

4.10 Schedule 4 of the bill provides for the addition of two organisations to the list of deductible gift recipients (DGRs) and a change in the name of one organisation already included as a DGR.[10]

4.11 The income tax law allows taxpayers to claim income tax deductions for gifts of $2 or more that are made to a DGR. The ITAA 1997 provides a list of DGR organisations in section 30-15.[11]

4.12 The inclusion of an organisation on the DGR list encourages support by offering tax deductions to those making donations.[12]

4.13 The two funds to be added to the DGR list are The Green Institute Limited, and United States Studies Centre Limited.[13]

4.14 The Green Institute Limited aims to engender 'education, exchange, research and debate' on:

> the principles of environment, social justice, non-violence and democracy. The key aim of the Green Institute is to promote those principles through training, networking, and research and policy development.[14]

4.15 The date of effect has been made retrospective to 24 June 2009; special conditions attached to the amendments provide that gifts made to this organisation after 23 June 2009 may be claimed as a deduction.[15]

4.16 The United States Studies Centre Limited is an organisation which aims to promote relations between the peoples of the United States, Australia and New Zealand through cultural awareness. Section 4.7 of the Explanatory Memorandum states that the aim of the fund is to:

> [r]esearch, debate and create new knowledge on American political, economic, social and cultural issues.[16]

4.17 The inclusion of the United States Studies Centre Limited on the list has also been made retrospective to 27 July 2009, thereby allowing gifts made to the fund after 26 July 2009 to be claimed as a tax deduction.[17]

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10 Explanatory Memorandum, p. 77.

11 Explanatory Memorandum, p. 77.

12 Explanatory Memorandum, p. 77.

13 Explanatory Memorandum, p. 78.

14 Explanatory Memorandum, para 4.6, p. 78.

15 Explanatory Memorandum, Table 4.1, p. 78.

16 Explanatory Memorandum, para 4.7, p. 78.

17 Explanatory Memorandum, Table 4.1, p. 78.

4.18 Schedule 4 amendments also propose that the name of the Dymocks Literacy Foundation Fund Limited, an existing education DGR, be changed to the Dymocks Children's Charities Fund, with the effect date 4 June 2009.[18]

4.19 Division 30 of the ITAA 1997 sets out the rules for deductions for certain gifts and contributions.

*Committee comment*

4.20 No submissions raised concerns or made comment in respect of Schedule 4.

**Recommendation 4**

**The committee recommends the Senate pass Schedule 4 without amendment.**

## Schedule 5 – Income Recovery Subsidy for the North Western Queensland floods

4.21 Schedule 5 makes provision for the Income Recovery Subsidy for the North Western Queensland floods to be exempt from income tax and kept apart from 'separate net income'.[19] The amendment will ensure that the law expressly states that this particular subsidy is exempt from income tax.

4.22 The subsidy was an emergency measure made available to Australian residents over 16 years of age whose income was adversely and directly affected by the North Western Queensland floods of January and February 2009. It formed part of a raft of measures such as services, payments and assistance that were already available to those taxpayers affected by the flooding.[20]

4.23 The payment was available to be claimed by victims of the floods after 24 February 2009. As a result, the income tax exemption proposed by Schedule 5 will be retrospective, the change effective from the 2008-09 income year.[21]

4.24 The amendment intends to lessen financial hardship.[22]

4.25 Submissions received to this inquiry did not comment on the changes proposed by Schedule 5.

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18 Explanatory Memorandum, Table 4.2, p. 78.

19 Including the payment in the calculation of separate net income may adversely impact the ability of these same taxpayers to access other tax offsets.

20 Explanatory Memorandum, p. 79.

21 Explanatory Memorandum, p. 81.

22 Explanatory Memorandum, paras 5.6 – 5.7, p. 79.

**Recommendation 5**

**The committee recommends the Senate pass Schedule 5 without amendment.**

## Schedule 6 – Excise manufacture and spirits

4.26 Schedule 6 of the bill proposes amending the *Excise Act 1901* to ensure that the blending of imported and domestic high strength neutral spirits constitutes 'excise manufacture'. This will ensure that high strength neutral spirits are imported at a free rate of duty under the *Excise Tariff Act 1921* concessional spirits regime.[23]

4.27 The concessional regime ensures that in those circumstances where particular spirits are imported for specified industrial, manufacturing, scientific, medical, veterinary or educational purposes, they are free of duty.

4.28 The amendment proposed is required as although the Excise Act contains provision to deem the blending of fuel to constitute excise manufacture, there is no equivalent provision for the blending of high strength neutral spirits.[24]

4.29 In the absence of the deeming provision, importers rely on an alternative method to ensure that the spirit is essentially free from duty.[25]

4.30 Schedule 6 will also provide the Commissioner of Taxation with the discretion to make determinations exempting certain activities from constituting excise manufacture.[26]

4.31 The amendments, if passed, will commence from the date of Royal Assent.[27]

### *Views on Schedule 6 – Excise manufacture and spirits*

4.32 As explained, Schedule 6 of the bill will introduce an addition to the *Excise Act 1901* to address a current legislative deficiency and ensure that imported high strength neutral spirits that are imported for specific purposes fall within the concessional spirits regime of the *Excise Tariff Act 1921*.

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23 Explanatory Memorandum, p. 83.

24 Explanatory Memorandum, para 6.6, p. 84.

25 Importers mix the imported high strength neutral spirit with domestic stocks – this transfers the spirit into the excise system and extinguishes any customs liability with the exception of any value component that is required to be paid at the time of a transaction. Explanatory Memorandum, para 6.5, p. 83.

26 Explanatory Memorandum, para 6.8, p. 84.

27 Explanatory Memorandum, para 6.10, p. 85.

4.33 The submissions received did not refer to Schedule 6.

**Recommendation 6**

**After consideration of the proposed amendment, the committee recommends the Senate pass Schedule 6 without amendment.**

**Senator Annette Hurley**

Chair

# APPENDIX 1

## Submissions Received

| Submission Number | Submitter |
|---|---|
| 1 | Taxation Institute of Australia |
| 2 | Mercer Australia Pty Ltd |
| 3 | Blake Dawson |
| 4 | Deloitte Touche Tohmatsu |
| 5 | ING Australia |
| 6 | Confidential |
| 7 | AXA |
| 8 | The Association of Superannuation Funds of Australia Limited |
| 9 | Mallesons Stephen Jaques |
| 10 | Suncorp |