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Tax Laws Amendment (2009 Measures No. 6) Bill 2009

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Contents

Tax Laws Amendment (2009 Measures No. 6) Bill 2009

Date introduced: 25 November 2009

House: House of Representatives

Portfolio: Treasury

Commencement: Royal Assent, or specific dates for particular provisions. Briefly, these dates are:

- **Schedule 2–Parts 1, 2 & 3** the day after Royal Assent
- **Schedule 2–Parts 4 & 5** 1 July 2013
- **Schedule 3–Part 1**, **Division 1** from 30 June 2000
- **Schedule 3–Part 2, Division 1** 22 June 2006
- **Schedule 3–Part 2, Division 2** 15 March 2007
- **Schedule 4–Part 1** 4 June 2009
- **Schedule 5–Part 1** 25 February 2009
- **Schedule 5–Part 2** 1 July 2011
- **Schedule 6–**Royal Assent.

All other provisions commence on the date Royal Assent is granted.

Links: The relevant links to the Bill, Explanatory Memorandum and second reading speech can be accessed via BillsNet, which is at http://www.aph.gov.au/bills/. When Bills have been passed they can be found at ComLaw, which is at http://www.comlaw.gov.au/.

Purpose

This Bill amends the following Acts for a range of taxation and related purposes:

- *Income Tax Assessment Act 1997* (ITAA 1997)
- *A New Tax System (Goods and Services Tax) Act 1999* (GST Act)
- *Tax Laws Amendment (2006 Measures No. 2) Act 2006* (TLAB 2 2006)
- *Superannuation Legislation Amendment (Simplification) Act 2007* (Simplification Act)
- *Income Tax Assessment Act 1936* (ITAA 1936), and
- *Excise Act 1901* (Excise Act).

The Bill contains six schedules, as follows:

- **Schedule 1** proposes changes to the capital gains tax (CGT) provisions to abolish the 'trust cloning' exceptions of the ITAA 1997 and provide for the roll-over of CGT when transferring assets between certain non-discretionary trusts
- **Schedule 2** contains amendments that will remove potential impediments to superannuation fund consolidation by allowing eligible entities to roll-over capital and revenue losses and transfer previously realised losses when merging. These measures will apply from 24 December 2008 to 30 June 2011
- **Schedule 3** proposes retrospective amendments to clarify the circumstances in which annuity income derived by life insurance companies can be treated as non-assessable non-exempt income
- **Schedule 4** sets out minor amendments to the list of deductible gift recipients
- **Schedule 5** contains amendments that will ensure income recovery subsidy payments to victims of the early 2009 north-west Queensland floods are exempt from income tax and are not included as separate net income for the purposes of calculating entitlement to certain tax offsets, and
- **Schedule 6** proposes amendment to the Excise Act to ensure that the blending of imported and domestic high strength neutral spirits constitutes excise manufacture. This will enable imported high strength neutral spirits to receive concessional duty treatment.[1]

Committee consideration

This Bill has been referred to the Senate Standing Committee on Economics (Legislation Sub-Committee) for inquiry and report by 25 February 2010. Details of the inquiry are at http://www.aph.gov.au/Senate/committee/economics_ctte/TLAB_6_09/index.htm

As the amendments in this Bill are unrelated, each schedule will be outlined in separate sections below.

1. Senate Standing Committee on Economics, Inquiry into Tax Laws Amendment (2009 Measures No. 6) Bill 2009, Information about the Inquiry, *website*, viewed 3 December 2009, http://www.aph.gov.au/Senate/committee/economics_ctte/TLAB_6_09/info.htm

Schedule 1–Abolishing trust cloning and providing CGT roll-over for certain trusts

Background

What is 'trust cloning'?

'Trust cloning' is the process where a new trust is created that has the same terms and beneficiaries as an original trust, so that assets can be transferred between them without raising a capital gains tax (CGT) liability.[2]

What tax mischief may arise from trust cloning?

Generally, capital gains arising from the increased value of an asset are taxed when the 'economic' ownership of that asset changes.[3] A change of economic ownership usually occurs where assets are transferred between trusts or where a trust is created over an asset. For example, where a family trust transfers an asset to another unrelated family trust a change in economic ownership occurs and a CGT liability arises. Likewise, where a trust is created over an asset a change of economic ownership occurs and a CGT liability also arises.

Two exceptions to this general rule occur under **subsections 104-55(5)** and **104-60(5)** of the ITAA 1997. Briefly, under these particular subsections, a CGT event does not occur (and therefore no CGT liability arises) where:

- a taxpayer is a sole beneficiary of the trust that was either created over the asset or into which the asset was transferred, and
- this taxpayer is absolutely entitled to the asset in question against the trustee (that is, the new trust in question is not a discretionary trust in relation to that asset), and
- the trust in question is not a unit trust,[4] **or**

2. Cited in J Kehoe, 'No more tax breaks for cloned trusts', *Australian Financial Review*, 7 November 2008, p. 21.

3. Treasury, *Abolish the capital gains tax trust cloning exception*, Discussion Paper, Canberra, 10 December 2008, p. 1.

4. 'A unit trust is a trust in which the beneficial ownership of the trust property is divided into a number of units. Although discretionary unit trusts do exist, the property of a unit trust is normally held on trust absolutely for the persons who for the time being are the holders of units in the unit trust (although the unitholders may themselves be the trustees of discretionary trusts) and there is normally no discretion to redistribute the beneficial interests in capital or income among the unitholders. A unit trust is governed by the same principles as other trusts and there must be property vested in the trustee for the benefit of beneficiaries. Like any other trust, a unit trust imposes obligations with respect to the trust property; and the trustee of a unit trust has, and in general is subject to, the same duties,

- where the asset is transferred from an existing trust into a new trust (whether the new trust was created by this transfer of the asset or it is an existing trust) and the beneficiaries and terms of both trusts are the same.[5]

The potential tax mischief arises from the existing provisions dealing with the last dot point above. The government considers that these exceptions are being used to allow the transfer of assets between individuals, frequently within family groups, that result in less, or no, tax being paid in circumstances that would normally give rise to a larger CGT liability.[6]

It is important to note that the provisions in the last dot point allow the CGT-free transfer of assets between trusts that have many beneficiaries, none of whom are necessarily entitled to the asset in question. These trusts are known as discretionary trusts, as it is up to the discretion of the trustee on how the assets of the trust are distributed. In discretionary trusts, it is quite possible for one person to contribute an asset to that trust, or have the trust purchase this asset with funds contributed by them, and have other individuals receive the benefits arising from this asset.

Such benefits may be received free of any CGT liability. Specifically, where an asset is transferred into the new trust, its cost base for CGT purposes in that new trust is its market value at the time of transfer. Normally, CGT is levied on the difference between the cost base of the asset (that is, its purchase price) and its sale price. Upon transfer into the new trust under abovementioned provisions the portion of the difference between the asset's original cost base (when it was originally purchased or transferred into the original trust), and its market value at the time of transfer, is excluded for assessment for CGT purposes when it is disposed of by the new trust. The proceeds of this disposal may be paid to any number of trust beneficiaries.

In extreme cases it may be possible for an asset to be transferred into a new trust under these provisions and then immediately sold. Thus its cost base would be equal to its sale price. There being no difference between the two amounts in these circumstances CGT is entirely avoided.

Briefly, the proposed amendments in **Schedule 1** remove the exemption from CGT where the assets are transferred to a discretionary trust.

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obligations and liabilities as the trustee of any other trust'. (CCH *2009 Australian Master Tax Guide*, Topic 31-560 – Unit Trusts)

5. The existing specific provisions preventing a CGT liability arising in these circumstances are paragraphs **104-55(5)(b)** and **104-60(5)(b)** of the ITAA 1997. Effectively, one part of the proposed amendments in **Schedule 1** removes these subparagraphs.

6. Senator N Sherry (Assistant Treasurer) *Legislation to boost integrity by abolishing the 'trust cloning' exception*, media release, no. 40, Canberra, 2 September 2009.

Are there any legitimate uses of trust cloning?

A number of submissions to Treasury during the policy development process noted the various uses of trust cloning unrelated to tax issues, such as:

- succession planning for family business
- asset protection for business,[7] and
- to facilitate the internal restructuring of various property related unit trusts.[8]

How do the proposed changes address these issues?

The proposed amendments permit CGT transfers of assets where the receiving trust:

- has a sole beneficiary, and
- that beneficiary absolutely entitled to the asset in question, and
- the receiving trust is not a unit trust.

These proposed provisions may be used in succession planning for a family business. Say a trust holds the assets of a business. Two or more new trusts could be created by transfer of the relevant assets. The beneficiaries of these new trusts, who would be absolutely entitled to the assets in question, could be intended recipients of the assets under the business succession plans.

Apparently, it is good business practice to protect business assets by separating them from the operations of that business.[9] The above provisions could be used to transfer business assets to a new trust that is separate from the operations of that business.

Part 2 of **Schedule 1** contains provisions that have as their objective 'to ensue that CGT considerations are not an impediment to the restructure of trusts', while also ensuring that these actions do not give rise to inappropriate CGT consequences (**Item 9** of **Schedule 1 new section 126-220** of the ITAA 1997).

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7. M Northeast (Executive Director Pitcher Partners), *Media release of 31 October 2008 (No. 092); Government Abolishes Trust Cloning Concession ("the proposed amendments"),* Submission to Treasury on trust cloning, 3 December 2008, and J Roberts (Vice President Taxation Institute of Australia), *Proposal to abolish the capital gains trust cloning exception,* Submission to Treasury on trust cloning, 5 December 2008.

8. R Fitzgerald (Executive Director International & Capital Markets, Property Council of Australia), *Proposal to abolish the tax cloning exception,* Submission to Treasury on trust cloning, 8 December 2008.

9. M Northeast, ibid. G Bullock, and 'Trust cloning gives ultimate independence', *The Australian*, 22 August 2007.

Basis of policy commitment

The proposed abolition of the trust cloning tax concession was announced by the then Assistant Treasurer on 31 October 2008.[10] He also announced the provision of limited CGT relief for the transfer of assets between certain fixed trusts on 12 May 2009.[11]

Policy development

There has been extensive consultation with legal, accounting and taxation policy groups leading up to the proposed changes. Some more recent highlights of this process have been:

- 29 April 2008: delivery of the Australian Taxation Office paper on trust cloning at a conference[12]
- 31 October 2008: Assistant Treasurer and Minister for Competition Policy and Consumer Affairs announces removal of CGT trust cloning exception of CGT events E1 and E2 and invites submissions on policy design[13]
- 5 November 2008: Treasury trust cloning discussion paper is released[14]
- early December 2008: Treasury receives 11 submissions mainly from legal and accounting groups[15]

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10. C Bowen MP (then Assistant Treasurer and Minister for Competition Policy and Consumer Affairs), *Government abolishes trust cloning tax concession*, media release, no. 92, Canberra, 31 October 2008.

11. C Bowen MP (then Assistant Treasurer and Minister for Competition Policy and Consumer Affairs), *Government acts to reduce compliance costs and improve tax law*, media release, no. 48, Attachment F, Canberra, 12 May 2009.

12. Australian Taxation Office, *Some CGT aspects of 'trust cloning – an ATO perspective*, Paper delivered by G Davies at a seminar conducted by the Taxation Institute of Australia, Windsor Hotel, Melbourne, 29 April 2008, viewed 4 January 2010, http://www.ato.gov.au/corporate/content.asp?doc=/content/00137188.htm

13. C Bowen MP (then Assistant Treasurer and Minister for Competition Policy and Consumer Affairs), *Government abolishes trust cloning tax concession*, *media release*, ibid. CGT event E1 occurs where a trust is created over an asset subject to CGT (**subsection 104-55(1)** of the ITAA 1997) and E2 occur where an asset is transferred between two pre existing trusts (**subsection 104-60(1)** of the ITAA 1997).

14. Treasury, *Abolish the capital gains tax trust cloning exception*, Discussion Paper, 5 November 2008, viewed 4 December 2009, http://www.treasury.gov.au/contentitem.asp?NavId=059&ContentID=1435

15. Treasury, *Submissions: Exposure Draft - Abolishing capital gains tax trust cloning exception*, 10 December 2008, viewed 4 December 2009, http://www.treasury.gov.au/contentitem.asp?ContentID=1448&NavID=059

- 12 May 2009: Assistant Treasurer and Minister for Competition Policy and Consumer Affairs announces that a limited CGT roll-over will apply for certain fixed trusts with same beneficiaries[16]
- September 2009: Draft legislation for proposed measures released and comment invited from interested parties[17]
- late September to early October 2009: Treasury receives seven submissions on draft legislation,[18] and
- December 2009: Treasury responds to submissions.[19]

Position of significant interest groups/press commentary

Press comment on this particular measure has been scant. However, the main comment is that the proposed changes unnecessarily restrict the ability to transfer assets between trusts without incurring a CGT liability.[20]

Industry submissions to Treasury in response to the release of the exposure draft generally acknowledge that the current provisions are too wide and may well lead to the undue avoidance of CGT. However, these submissions generally consider that the proposed changes are too narrow, and prevent many, mainly discretionary, trusts from taking advantage of the proposed CGT relief provisions upon the transfer of assets.[21]

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16. C Bowen MP (then Assistant Treasurer and Minister for Competition Policy and Consumer Affairs) *Government acts to reduce compliance costs and improve tax law*, op. cit.

17. Treasury, *Exposure Draft – Abolishing the capital gains tax trust cloning exception and providing a roll-over for fixed trusts*, op. cit.

18. Treasury, *Submissions: Exposure Draft – Abolishing the capital gains tax trust cloning exception and providing a roll-over for fixed trusts*, 14 October 2009, viewed 4 January 2010, http://www.treasury.gov.au/contentitem.asp?ContentID=1641&NavID=059

19. Treasury, *Abolishing the capital gains tax (CGT) trust cloning exception and providing a roll-over for fixed trusts*, *Summary of Consultation Process*, December 2009, viewed 4 January 2010, http://www.treasury.gov.au/documents/1610/PDF/Consultation_Summary.pdf

20. J Kehoe, 'No more tax breaks for cloned trusts', *Australian Financial Review*, 7 November 2008, p. 2; Sara Rich, 'Law to halt CGT dodging by trusts', *The Australian*, 3 September 2009, p. 2.

21. For example, Y El-Ansary, (Tax Counsel – Institute of Chartered Accountants in Australia), *Exposure draft – Abolishing the capital gains tax trust cloning exception and providing a roll-over for fixed trusts*, Submission to Treasury on trust cloning, 6 October 2009; M Northeast (Executive director – Pitcher Partners), *Submission concerning abolishing the capital gains tax trust cloning exception and providing a roll-over for fixed trusts ("the proposed amendments")*, op. cit.

Many submissions provided valuable technical comment on the proposed legislation, which have either been adopted or were rendered unnecessary by other changes that have been made. Despite these valuable comments, Treasury has observed that the majority of submissions actually opposed the proposed amendments.[22]

Pros and cons

The existing provisions are capable of allowing the complete evasion of CGT obligations and the proposed amendments deal with this particular problem. Further, the proposed amendments do not appear to prevent the use of trust cloning to deal with the non-tax issues noted above.

That said, the range of circumstances where trust cloning may be used in relation to these non-tax issues may well be restricted by the proposed amendments.

Financial implications

The proposed changes are reported as having an unquantifiable financial impact, but in any case that impact is expected to be small.[23]

Main provisions

Part 1–removing trust cloning exception

Items 1 and **2** of Schedule 1 repeal existing subsections 104-55(5) and 104-60(5) of the ITAA 1997 and replace these subsections with new text. This new text restricts the exemption from CGT events E1 and E2 to situations where:

- the taxpayer is the sole beneficiary of the trust either created by a transfer of an asset or an existing trust that receives the asset, and
- the taxpayer is absolutely entitled to the asset in question, and
- the receiving trust is not a unit trust.

Effectively this restricts the CGT exemption only to trusts meeting these criteria. The provisions that allow the CGT exemption for events E1 and E2 to apply to discretionary trusts have been removed.

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

23. Explanatory Memorandum to Tax Laws Amendment (2009 Measures No. 6) Bill 2009, p. 7 (hereafter referred to as Explanatory Memorandum).

Item 3 applies the amendments made in **Part 1** of **Schedule 1** to CGT events happening on or after 1 November 2008. This application date was clearly stated in the media release first announcing this particular measure.[24]

Part 2 – Roll-over for certain trusts

Item 9 inserts **new subdivision 126-G** into the ITAA 1997 to deal with the transfer of assets between certain trusts. As noted above, the object of this new subdivision is to ensure that CGT considerations are not an obstacle to the restructuring of certain trusts, but at the same time ensuring that CGT is paid at the appropriate time (**new section 126-220**).

Briefly, **new section 126-225** of the ITAA 1997 sets out additional conditions under which an asset may be transferred to another trust without raising a CGT obligation. The main conditions are:

- an existing receiving trust has no other assets in it, save those that are transferred under the provisions of this subdivision, and
- the receiving trust has the same beneficiaries as the original trust, with the same rights, and
- the market value of the assets transferred is the same as the market value of those assets in the original trust just before the transfer took place.

The general requirement that a receiving trust must not have any other assets in it (save those also transferred under the provisions of this subdivision) is a contentious one. It has been argued that this requirement is too restrictive. Treasury has noted that the requirement that the receiving trust is to be an empty trust is an important integrity measure to prevent the inappropriate sharing of gains and losses.[25]

For the CGT exempt transfer of assets between trusts, **new section 126-230** requires that:

- CGT event E4 is capable of happening,[26] and
- the beneficiary's entitlements to these assets must not be discretionary. That is, the beneficiary's entitlement to these assets is not subject to the discretion of the trustee.

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24. C Bowen MP (then Assistant Treasurer and Minister for Competition Policy and Consumer Affairs), *Government abolishes trust cloning tax concession, media release*, op. cit.

25. Treasury, *Abolishing the capital gains tax (CGT) trust cloning exception and providing a roll-over for fixed trusts, Summary of Consultation Process*, op. cit.

26. CGT event E4 occurs where the trustee makes a payment to a beneficiary and that payment is not included in that beneficiary's assessable income for taxation purposes (subsection 104-70(1) of the ITAA 1997). The Explanatory Memorandum, at page 16, notes that this requirement ensures that discretionary trusts cannot make use of this sub-division's provisions.

Under the provisions of **new section 125-235** of the ITAA 1997 a CGT-free roll-over will not be allowed where:

- the receiving trust is a foreign trust for CGT purposes[27]
- the asset transferred is not 'taxable Australian property' just after the transfer[28]
- the receiving trust(s) is subject to **sections 102K** or **102S** of the ITAA 1936 (that is the receiving trust cannot be a corporate unit trust or a public trading trust), and
- a choice under a taxation law[29] is in force in respect of the asset being transferred and the same type of choice (sometimes called an election) is not in force in respect of that asset in the receiving trust, and the absence of that choice in the receiving trust make a difference in the calculation of that trust's net income or taxable income[30]

Item 11 requires that the provisions contained in **items 4** to **9** (effectively all of **new sub-division 126-G** of the ITAA 1997) apply to events happening on or after 1 November 2008.

Concluding comments

It may be argued that the existing provisions of the ITAA 1997 (**sections 104-55** and **104-60**) have not to date been used for widespread CGT avoidance. However, as the paper given by the Australian Tax Office (ATO) in April 2008 demonstrates, the Commissioner of Taxation has been concerned about problems in administering these sections. These

27. Subsection 995-1 of the ITAA 1997 defines a 'foreign trust for CGT purposes' as one that is not a resident trust for CGT purposes. The same section defines the latter term as a trust where (for a trust that is not a unit trust) a trustee is an Australian resident or the central management and control of the trust is in Australia, or (for a unit trust) any property of the trust is in Australia and the central control and management of that trust is also in Australia; or that trust carries on a business in Australia and Australia residents held more than 50 per cent of the beneficial interest in the income or property of that trust.

28. 'Taxable Australian property' is defined in subsection 995-1 of the ITAA 1997 by reference to section 855-15 of the same Act.

29. Subsection 995-1 of the ITAA 1997 defines 'taxation law' to mean an Act of which the Commissioner has the general administration (including a part of an Act to the extent to which the Commissioner has the general administration of the Act); or regulations under such an Act (including such a part of an Act).

30. Income tax legislation provides taxpayers with a number of choices or options. For example, the original trust may have a family trust election in relation to the transferred asset and a specific individual. If that same election or choice is not in force, and it makes a difference in calculating the receiving trusts income, a CGT obligation will arise in respect of the transferred asset.

provisions have also been the subject to a number of clarifying rulings, indicating that that these concerns have existed for some time.[31] An earlier press article cited above may be taken as evidence that the possibility of using these sections to avoid CGT obligations has been generally known amongst tax professionals.[32]

Schedule 2–Loss relief for merging superannuation funds

Generally, the provisions of this Schedule insert **new Division 310** into the ITAA 1997. The new division deals with the transfer of capital and income losses to a successor fund when two superannuation funds merge.

The transfer of assets from one superannuation fund to another, under a merger between the two funds, will typically trigger CGT event A1 (**section 104-10** of the ITAA 1997) and the realisation of capital gains or capital losses for the transferring fund as appropriate.[33]

Under current legislation net capital losses are extinguished on the ending of the transferring fund, and are unavailable for use in the successor fund. Had the transferring fund continued, they would have been available to reduce that fund's overall CGT liability.[34] The proposed new Division will allow the transfer of losses to a successor fund when two superannuation funds merge.

The proposed changes are a temporary measure applying to mergers that occur(ed) from 24 December 2008 to 30 June 2011.[35] The Government has stated that it will review this measure after it has considered the report of Australia's Future Tax System Review.[36]

31. Australian Taxation Office, *TR 2006/4 – Income tax: capital gains: meaning of the words 'the beneficiaries and terms of both trusts are the same' in paragraphs 104-55(5)(b) and 104-60(5)(b) of the Income Tax Assessment Act 1997*, Taxation ruling, 28 June 2006: *TD 2004/14 Income tax: capital gains: does CGT event E2 in section 104-60 of the Income Tax Assessment Act 1997 happen if a CGT asset is transferred between two trusts and the beneficiaries and terms of both trusts are the same?*, Tax Determination, 21 April 2004.

32. G Bullock, 'Trust cloning gives ultimate independence', op. cit.

33. CGT event A1 occurs on the disposal of a CGT asset.

34. Treasury, *Capital gains tax roll-over for complying superannuation funds with capital loses* Discussion paper, Canberra, 16 January 2009, p. 2.

35. **Item 11** of **Schedule 2** to the Bill.

36. Senator N Sherry (then Minister for Superannuation and Corporate Law) *Optional CGT loss roll-over for complying super fund,* media release, no 101, Canberra, 23 December 2008.

Background

Trends in superannuation fund numbers and size of funds

The number of superannuation funds regulated by the Australian Prudential Regulation Authority (APRA) has declined steadily over recent years, as the following table shows:

Table 1: Number of APRA regulated superannuation entities June 2005 to September 2009

Fund type	Jun-05	Jun-06	Jun-07	Jun-08	Jun-09	Sep-09
Corporate	962	555	287	226	190	186
Industry	90	80	72	70	68	67
Public Sector	43	45	40	40	40	40
Retail	228	192	176	179	165	164
PST[37]	130	123	101	90	82	82
Totals	1453	995	676	605	545	539

Source: APRA[38]

In the above table, the fund type mainly refers to the broad economic sector that provides the superannuation fund in question. So, the corporate funds are those provided by large corporate entities, such as Telstra, for their own employees. Industry funds are those provide by both employee and employer organisations and mainly (but not exclusively) are used by members of that industry. Retail funds are provided by large fund managers, such as banks and life insurance offices.

The above table does not include the number of small superannuation funds (that is those with less than 5 members), as they are not subject to the proposed changes and are regulated by the ATO. The overall decline in superannuation fund numbers is part of a larger trend stretching back over 10 years.

There are several causes of the above trend. Some funds are simply wound up; their members have retired and the fund no longer has a reason to exist. The business of some funds is transferred to a new provider. For example, many corporate entities have decided that they are not in the business of providing superannuation services for their employees and have subcontracted this service out to other providers (mainly retail and industry funds). Changes in superannuation arrangements in the public sector have led to a decline in number of funds provided by governments for their employees. But by far the main

37. PST stands for Pooled Superannuation Trust. These entities are large superannuation funds that are run by fund managers on a wholesale basis. Individual superannuation funds place large amounts of funds in these vehicles. They are not open generally to retail investors.

38. APRA, *Statistics – Annual Superannuation Bulletin*, June 2008, Sydney 10 June 2009, p. 28; *Statistics – Quarterly Superannuation Performance*, September 2009, Sydney, 10 December 2009, p. 7.

reason behind the decline in the number of superannuation funds is that they merge with another superannuation fund.

Why do superannuation funds merge?

The merging of superannuation funds may provide several advantages to both members and fund providers, such as:

- gaining economies of scale in respect of the fixed costs of running a fund. Such costs have increased with the move by APRA to formal licensing of superannuation trustees[39]
- larger funds may have access to a wider range of investment opportunities
- the very largest funds, often created by mergers, may be in a position to adopt a more stable approach to investment management where they become custodians of cash flows (from which benefits are paid) rather than buyers and sellers of assets. All other things being equal this will lessen the pressure to sell assets at inappropriate times[40]
- some smaller funds perceive that they are unable to meet APRA's regulatory requirements, especially the requirements for superannuation fund trustee licensing. A larger fund may have better resources to meet these ongoing administrative requirements[41]
- larger funds may be able to demand lower fees from service providers (such as investment brokers) in return for an increased volume of transactions,[42] and
- the transfer of members of several older, smaller, superannuation funds into a newer fund cuts down overall administration costs. This is of particular relevance to retail superannuation providers that may have older, smaller, superannuation funds with smaller memberships. The transfer into a newer, larger, single fund eliminates the cost of continuing to run several smaller funds.

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39. From 1 July 2006 all superannuation trustees have to be licensed by APRA to be able to undertake this task. The costs of licensing are large and the licensing process is complex. For more information on this process see APRA, Superannuation – Licensing and registering a superannuation entity, information kit, Sydney, July 2004, viewed 6 January 2010, http://www.apra.gov.au/Superannuation/upload/Superannuation-Licensing-Explanatory-guide-on-licensing-and-registration.pdf

40. B Dunstan, 'A good thing can become even better', *Australian Financial Review*, 24 October 2009, p. 39.

41. B Swift, 'Competition spurs super fund mergers', *Australian Financial Review*, 14 June 2006, p. 60.

42. D Hughes, 'Fees will bring on super fund mergers', *Australian Financial Review*, 29 July 2009, p. 53.

What funds have merged, and what funds are expected to merge?

The most specular recent example of superannuation funds merging has been the creation of the AustralianSuper fund, from a merger of the former Retirement Fund of Australia and the Superannuation Trust of Australia in 2006. After a review of the new fund in 2007, financial and investment research group ChantWest gave it a very high rating.[43]

Reportedly, from January 2009, at least 10 superannuation funds were intending to merge during that year in response to the announcement of temporary tax relief granted to merging funds in 2008.[44] Those reportedly taking advantage of the proposed tax relief are:

- National Catholic Superannuation Fund and Catholic Super
- Stevedoring Employers Retirement Fund and Seafarers Retirement Fund, and
- Victorian Bar Superannuation Fund and Blake Dawson Partners Superannuation Fund.[45]

It is interesting to note that the above list of possible mergers (which is by no means exhaustive) features arrangements between small funds in the same general industrial, religious or occupational group. This point underscores the importance of cultural factors when merging superannuation funds. It may also indicate a limiting factor in arranging any further superannuation fund mergers, as there is a limit to the number of funds that service similar occupational, religious or occupational groups.

Basis of policy commitment

In December 2008, the then Minister for Superannuation and Corporate Law announced that the Government would provide an optional CGT roll-over for capital losses arising when two superannuation funds, with at least 5 members or more, regulated by APRA, merge before 1 July 2010.[46] This deadline was later extended to 1 July 2011, and the scope of the proposed changes was extended to include pooled superannuation trusts (PSTs) and a wider range of capital losses.[47]

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43. B Dunstan, 'A giant exposed: she's apples', *Australian Financial Review*, 11 April 2007, p. 36.

44. S Patten, 'Tax relief paves way for superannuation mergers', *Australian Financial Review*, 27 January 2009, p. 44.

45. D Hughes, 'Fees will bring on super fund mergers', op. cit.

46. Senator N Sherry, (then Minister for Superannuation and Corporate Law) *Optional CGT loss roll-over for complying super funds*, op. cit.

47. Senator N Sherry (then Minister for Superannuation and Corporate Law), *Expansion of the optional CGT loss roll-over for complying super funds that merge*, media release, no. 042, Canberra, 29 April 2009.

Policy development

Both the policy and the implementing legislation have been the subject of extensive consultation, as the following time line suggests:

- December 2008: the then Minister for Superannuation and Corporate Law announced that there would be an optional CGT loss roll-over when two complying superannuation funds merge[48]
- January 2009: the then Minister for Superannuation and Corporate Law released a discussion paper on the option capital gains tax roll-over for complying superannuation funds[49]
- February 2009: Treasury receives 18 submissions from industry and accountancy groups in response to the above mentioned discussion paper[50]
- April 2009: date for ending temporary tax relief extended to 30 June 2010 and proposed relief expanded to include PSTs
- July 2009: exposure draft of legislation implementing this measure released, and
- September 2009: Treasury had received 13 submissions in response to the exposure draft of the legislation.[51]

Position of significant interest groups/press commentary

Generally, industry groups welcome the proposed changes, considering that they would benefit the industry. However, several groups requested that the scope of the proposed changes be further extended to include a wider range of situations.[52] Press comment on the proposed changes was generally favourable.[53]

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48. A superannuation fund has to meet the conditions prescribed in section 42 of the *Superannuation Industry (Supervision) Act 1992* (SISA) in order to qualify as a complying superannuation fund. Only complying superannuation funds receive concessional tax treatment.

49. Senator N Sherry (then Minister for Superannuation and Corporate Law), *Minister releases discussion paper on tax relief for merging super funds*, media release, no. 3, Canberra, 16 January 2009.

50. Treasury, *Submissions: Optional capital gains tax roll-over for complying superannuation funds with capital losses*, 23 February 2009, viewed 6 January 2010, http://www.treasury.gov.au/contentitem.asp?ContentID=1486&NavID=037

51. Treasury, *Submissions: Exposure draft – superannuation funds loss roll-over*, 14 September 2009, viewed 6 January 2010, http://www.treasury.gov.au/contentitem.asp?ContentID=1621&NavID=037

52. B Grant (Secretary-General Law Council of Australia), *Exposure Draft: Tax Laws Amendment (2009 Measures No. 6) Bill 2009: Roll-Over for merging superannuation funds*, Submission to Treasury, 27 August 2009; M Howes (Director – Policy and Industry

Pros and cons

There is little doubt that the proposed changes will facilitate the merger of smaller superannuation funds by allowing losses realised by one superannuation fund to be carried into the new fund. This capacity is quite important for superannuation funds, as severe losses were experienced during the recent global financial crises. The ability to retain these losses for use in a new entity has been welcomed by the industry.

However, as noted above, the proposed changes may not cover the entire range of situations where superannuation entities merge or where it may be desirable to transfer assets between one fund and a successor fund.

Financial implications

The Explanatory Memorandum notes that this particular measure will have an unquantifiable, but small, revenue cost.[54]

Main provisions

Part 1–Main amendment

Item 1 of this Part of Schedule 2 inserts **new Division 310** into the ITAA 1997. **New section 310-5** notes that the object of this new 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 available as a result of the merger.

New sections 310-10, **310-15** and **310-20** of the ITAA 1997 allow the trustee of a superannuation fund to transfer losses to a 'continuing [superannuation] fund'. For this transfer to take place all the original fund's members (except in the case of a PST) must be transferred to one or more complying superannuation funds, called the 'continuing fund' in this particular Bill. Usually, the continuing fund will not be a 'small superannuation

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Practice, Association of Superannuation Funds of Australia), *Submission on Exposure Draft Legislation – CGT roll-over for complying superannuation funds with capital losses*, Submission to Treasury, August 2009; B McBain (Chief Executive Officer – Corporate Superannuation Association), *Exposure Draft – Superannuation Funds Loss Roll-Over*, Submission to Treasury, August 2009; J O'Shaughnessy (Deputy Chief Executive Officer – Investment and Financial Services Association of Australia), *Exposure Draft Superannuation Funds Loss Roll-Over legislation*, Submission to Treasury, 26 August 2009.

53. AAP, 'Super fund mergers to be made cheaper', *Canberra Times*, 30 April 2009, p. 6; S Patten, 'Tax relief paves way for superannuation mergers', op. cit

54. Explanatory Memorandum, p. 8.

fund'. However, it should be noted that there is no obligation on a trustee to transfer the losses in this way.[55]

As noted above, a superannuation fund has to meet the conditions prescribed in section 42 of the *Superannuation Industry (Supervision) Act 1993* (SISA) in order to qualify as a complying superannuation fund for the purposes of the ITAA 1997. Under **section 955-1** of the ITAA 1997 a small superannuation fund is a complying superannuation fund with four or fewer members.

New section 310-25 allows the transfer of any or all losses incurred, in whole or in part to:

- a continuing superannuation fund
- a PST, or
- a life insurance company with a complying superannuation/First Home Saver Account (FHSA) life insurance policy.[56]

New section 310-30 allows the transfer of any net capital loss, or tax loss, incurred in an income year, earlier than the one in which the transfer took place.

Under **new section 310-45** of the ITAA 1997 an entity may choose to roll-over (transfer) assets to a new superannuation fund, if:

- that entity makes, or could choose to make, a transfer of losses under the above mentioned sections of this Bill, and
- the original or source superannuation fund ceases to own the said assets to which the choice to transfer the losses relates, and
- the transfer of assets must happen in the income year that the transferring entity completes the transfer of the losses, and
- the assets become the asset of the superannuation entity to which the corresponding losses are transferred.

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55. The use of the verb 'can' (as opposed to 'must') in **proposed subsections 310-10(1), 310-15(1)** and **310-20(1)** indicates discretion on the part of the transferring entity. Ideally the word 'may' would be better than 'can'. See subsection 33(2A) of the *Acts Interpretation Act 1901*.

56. The complying superannuation/FHSA insurance policy is one of the two classes of taxable income of a life insurance company, the other being the ordinary class. The complying superannuation/FHSA class of taxable income replaced the 'complying superannuation class of insurance policy' from the 2008–2009 year to take account of the FHSA business of a life insurance company. The complying superannuation/FHSA class is taxed at the concessional rate of 15 per cent, the same rate as that applying to other superannuation entities. (*CCH Australian Master Superannuation Guide 2009* – Topic 13-050 - KEY TERMS)

The overall requirement of this particular provision appears to be that a transfer of losses must be accompanied by a transfer of the assets in question.

Part 3–application provision

Item 11 applies the changes made by **Parts 1** and **2** of **Schedule 2** to events that occur during the period starting on 24 November 2008 and ending on 30 June 2011.

Concluding comments

Though the proposed changes may not go as far as the superannuation industry would have liked, they still remove significant impediments to the merger of superannuation funds over the set time period.

Schedule 3 – Exempt annuity business of life insurance companies

As noted above, the aim of **Schedule 3** is to clarify the circumstances in which income derived by life insurance companies qualifies as non-assessable non-exempt income for taxation purposes. It achieves this aim by amending the conditions for an annuity to be classified as ‘exempt annuity business of life insurance companies’ with apparent effect from 30 June 2000 and then again amending those conditions with effect from 1 July 2007.[57]

Background

What is an annuity?

Simply put, an annuity is simply a regular series of payments. Generally, annuities are sold by life insurance companies and are a regular series of payments usually in exchange for a significant amount of money. Generally, they take the form of an insurance contract where the insurance company agrees to pay a specified income, over a specified time frame to the life insured (be that period one year or the rest of the insured person’s life).

For taxation purposes the term annuity is defined in **section 995-1** of the ITAA 1997 to include:

> (a) an annuity, within the meaning of the *Superannuation Industry (Supervision) Act 1993*; or

57. If the annuity is an ‘exempt life insurance policy’, the life insurance company can segregate assets to be used for the sole purpose of discharging its liabilities under life insurance policies where the income derived by the company from these policies is exempt from income tax. See Subdivision 320-H of the ITAA 1997, including section 320-246.

(b) a pension, within the meaning of the *Retirement Savings Accounts Act 1997* [RSA]

These latter Acts define an annuity as follows:

- in the SISA - annuity includes a benefit provided by a life insurance company or a registered organisation (generally associated with a trade union), if the benefit is taken, under the regulations, to be an annuity for the purposes of this Act[58]
- in the RSA – the term pension (except in the expression old-age pension) means a benefit, if the benefit is taken, under the regulations, to be a pension for the purposes of this Act.[59]

What is an exempt annuity?

As noted above, **Schedule 3** is entitled the 'Exempt annuity business of life insurance companies'. But what exactly is an 'exempt annuity'? Unfortunately, there is no statutory definition of the term 'exempt annuity'.

A life insurance company may maintain a pool of segregated assets (known as 'segregated exempt assets'). Segregated exempt assets must be used for the sole purpose of discharging the company's liabilities under exempt life insurance policies (ITAA 1997 section 320-225).

An exempt life insurance policy, in section 320-246 of the ITAA 1997 is (amongst other things) a life insurance policy held by the trustees of a complying superannuation fund or a PST for the discharge of that fund's pension liabilities.

The ordinary income and statutory income derived from the segregated exempt assets (being income relating to the segregation period) is non-assessable non-exempt income under ITAA 1997 paragraph 320-37(1)(a).

It follows for the above-noted provisions that an exempt annuity is one that is backed by exempt assets, provided under an exempt life insurance policy and which produces non-assessable non-exempt income.

58. Section 10, SISA. Regulation 1.05 of the Superannuation Industry (Supervision) Regulations 1994 (SIS Regulations) goes on to provide an exhaustive definition of the term annuity. However, it is the tax treatment of the income produced by these products that is the immediate concern of **Schedule 3**.

59. Regulation 1.07 of the Retirement Saving Accounts Regulations 1997 defines the term pension in very similar terms to those of regulation 1.05 of the SIS Regulations noted above.

What is non-assessable non-exempt income?

Non-assessable non-exempt income is ordinary or statutory income that is expressly made neither assessable income or exempt income. This category of income was introduced in 2003 to prevent overlap of the various other categories of income.[60]

The important point is how non-assessable non-exempt income is treated for taxation purposes. In these particular circumstances the inclusion of these annuities as exempt life insurance business is to prevent double taxation, once in the hands of the life insurance company and once in the hands of the annuity recipient.[61] If the annuity is not superannuation-based its income is generally taxed in the hands of the recipient.

Simplified superannuation changes

From 1 July 2007 income derived from a superannuation pension is not subject to income tax (**section 301-10** of the ITAA 1997). This applies to the payment of a lump sum or an income stream, provided these benefits:

- had previously been subject to the normal rate of income tax applied to superannuation funds (that is benefits 'taxed' in the fund), and
- the recipient was age 60 years or over.

In these circumstances the benefits received are classed as non-assessable non-exempt income for taxation purposes.

Comment

The importance of the provisions noted above is that there is a clear legislative commitment to exempting all superannuation-based income from income tax if the recipient is over 60 years of age and the benefits were previously taxed within the fund. If superannuation-based annuities, received by this class of person, were taxed in the hands of the life insurance company, this outcome would not occur. Hence there is a need to clarify that superannuation-based annuities are included in the exempt annuity business of life companies.

The annuity provisions of the ITAA 1936 (former subsection 110(1) and Part IX more generally) were rewritten in July 2000 and inserted into the ITAA 1997.[62] These changes in wording and style were not intended to change the operation of the law. However, concerns about anomalies in the law have arisen due to subsequent changes in the annuity

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60. *CCH Australian Master Tax Guide 2009,* Topic 1-250 – Income.

61. Explanatory Memorandum, p. 67.

62. Ibid.

provisions.[63] It may be the case that the current annuity conditions (specifying what type of annuity may qualify as an exempt annuity business of a life insurance company) may apply to a narrower range of annuity contracts than was previously the case.[64] The proposed amendments are intended to correct what essentially appears to be a series of slight drafting errors that occurred during the rewrite of these provisions and their insertion into the ITAA 1997.

Basis of policy commitment

The then Assistant Treasurer and Minister for Competition Policy and Consumer Affairs announced this particular set of amendments on 12 May 2009.[65]

Policy development

The Government released a discussion paper on this matter on 12 May 2009.[66] To date, the outcome of these consultations has not been released.

Pros and cons

To the extent that the proposed changes ensure that superannuation-based immediate annuity payments continue to be tax free in the recipient's hands if they are over 60 years of age the proposed changes are consistent with well-established policy.

Financial implications

The Explanatory Memorandum notes that these proposed changes are expected to have a small, but unquantifiable, revenue impact.[67]

Main provisions

The structure of the provisions in **Schedule 3** is unusual, in that **Part 1** mainly amends the current annuity conditions in **section 320-246** ITAA 1997, with effect from 30 June 2000. **Part 2** of this schedule then amends the changes made in **Part 1**, with effect from 1 July

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63. Thomson Reuters, *Weekly Tax Bulletin*, 27 November 2009, p. 2190.

64. Treasury, *Discussion paper: Life insurance companies – exempt annuity business*, 12 May 2009, p. 2, viewed 7 January 2010, http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=1527

65. C Bowen MP (then Assistant Treasurer and Minister for Competition Policy and Consumer Affairs), *Government acts to reduce compliance costs and improve the tax law*, media release, no. 48, Canberra, 12 May 2009, Attachment C.

66. Treasury, *Discussion paper: Life insurance companies – exempt annuity business*, op. cit.

67. Explanatory Memorandum, p. 8.

2007 (being the start of the 2007–2008 income year for most personal income tax purposes).

Part 1

Item 2 repeals **subsections 320-246(3)** to **(5)** of the ITAA 1997 and inserts a new subsection 3. The effect of this amendment is to rewrite the annuity conditions for such products to be classed as exempt annuity business of life insurance companies in line with the provisions of former subsection 110(1) of the ITAA 1936.

Comment

Part 1 is entitled 'Amendments applying from 30 June 2000' and comprises two divisions: one amending the ITAA 1997, and the other amending the *Tax Laws Amendment (2006 Measures No. 2) Act 2006*. **Clause 2** of the Bill states that **Division 1** of **Part 1** commences on 30 June 2000, being immediately after the commencement of item 57 of Schedule 1 to the *Tax Laws Amendment (2004 Measures No. 2) Act 2004*.[68]

The amendments in **Part 1** ensure that the annuity conditions applying between 1 July 2000 and 30 June 2007 are consistent with the annuity conditions in the ITAA 1936 applying before 1 July 2000.

Part 2

Item 4 repeals **subparagraphs 320-246(e)(i)** to **(iii)** and replaces these subparagraphs with new text.[69]

Items 5 to **8** amend **new subsection 320-246(3)** inserted by amendments in **Part 1**.

Part 2 commences retrospectively on 15 March 2007, being the date when the *Superannuation Legislation Amendment (Simplification) Act 2007* commenced. Among other things Schedule 1 of that Act repealed Division 10 of Part IX of the ITAA 1936 and amended section 320-246 of the ITAA 1997.

Comment

The Explanatory Memorandum notes that the purpose of these particular changes is to ensure that the annuity conditions do not apply to immediate annuity policies that provide for superannuation-based income streams.[70]

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68. Item 57 of Schedule 1 to that Act inserted section 320-46 (Exempt life insurance policy) into the ITAA 1997, so the amendments in the current Bill have the effect of amending section 320-46 from that section's commencement.

69. **Item 1** of **Part 1** amended **subparagraphs 320-246(e)(ii)** and **(iii)**.

At first glance this may be read as suggesting that these annuities would be subject to tax in the hands of the life insurance company operating these policies. However, these annuities are backed by segregated exempt assets. Income generated by such superannuation-based assets is not subject to tax in the hands of the life insurance company making the payments.[71] As noted above, if the recipient is over 60 years of age these payments are also free of personal income tax.

Part 3

Item 11 applies the amendments made by **Division 1** of **Part 2** of this schedule to the 2007–2008 and later income years.

Schedule 4–Deductible gift recipients

Part 1 of this Schedule amends the name of the Dymocks charity in the list of current deductible gift recipients in the ITAA 1997.

Part 2 adds two additional deductible gift recipients to the current list of such entities in the ITAA 1997. They are the Green Institute Limited and the United States Studies Centre.

Part 3 applies the changes in **Schedule 4** to the 2008–2009 and later income years.

Schedule 5–North Western Queensland floods

As noted above, the amendments in **Schedule 5** ensure that particular amounts paid to victims of the North Western Queensland floods in early 2009 are not subject to income tax and not included in the 'separate net income' of a person receiving these payments.

Background

These payments were announced by the Minister for Families, Housing, Community Services and Indigenous Affairs in Parliament on 25 February 2009.[72]

Payments were made between February and April 2009, to persons over 16 years of age who experienced a loss of income as a direct result of the North Queensland and North Western Queensland floods in January and February 2009.

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70. Explanatory Memorandum, p. 68.

71. Section 320-37, ITAA 1997.

72. J Macklin MP (Minister for Families, Housing, Community Services and Indigenous Affairs), 'Response to question without notice', House of Representatives, *Debates*, 25 February 2009, p. 1792.

A tax exemption and exclusion from the definition of 'separate net income' was introduced in March 2009 for the Income Recovery Subsidy paid in respect of the North Queensland flood.

The amendments in this schedule essentially introduce the same tax concessions in respect of the payments made in respect of the North Western Queensland flood, as apply to payments made in respect of the North Queensland flood.[73]

What is 'separate net income'?

The concept of 'separate net income' relates to the income of a dependant of a tax payer and is used for calculating that taxpayer's entitlement to tax offsets (i.e. tax rebates).

The 'separate net income' is the dependant's gross income (including salary and wages, interest, dividends, business, rental and trust income, income from a partnership, pensions and some social security payments) *less* expenses that, in accordance with ordinary accounting and commercial principles, are direct costs against that income. It is not the same as that person's taxable income (which is gross assessable income less *all* deductions, including any non-business deductions).[74]

Basis of policy commitment

These measures were announced in the Mid-Year Economic and Fiscal Outlook 2009–10.[75]

Pros and cons

Obviously, the exemption of these payments from assessable income and from the definition of separate net income will assist victims of these floods.

Significant technical flaws

Item 1 of Schedule 5 amends the definition of 'separate net income' in subsection 159J(6) of the ITAA 1936. At first glance the proposed amendment is alarming because this particular subsection is no longer in the statute, having been repealed in 2009 by item 99 of Schedule 3 to the *Tax Laws Amendment (2009 Measures No. 1) Act 2009* (Act No. 27 of 2009). Schedule 3 to that Act commenced on 27 March 2009.

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73. Thomson Reuters, op. cit.

74. CCH *2009 Australian Master Tax Guide*, Topic 15-060 –What is separate net income?

75. Australian Government, *Mid Year Economic and Fiscal Outlook 2009–10*, Canberra, 2 November 2009, p. 140, viewed 8 January 2010, http://www.budget.gov.au/2009-10/content/myefo/download/MYEFO_2009-10.pdf

Part 1 of **Schedule 5** to the current Bill is intended to commence (retrospectively) on 25 February 2009, being the date of the Minister's announcement mentioned above.

Thus the amendments in **Part 1** of **Schedule 5** to the current Bill only operate between 25 February 2009 and 27 March 2009. Assuming the flood income subsidy payments were made during that period, they will be exempt from income tax and also from inclusion in any assessment of 'separate net income' in the 2008–2009 income year.[76]

The other unusual thing to note is that the amendments made by **Schedule 3** to the *Tax Laws Amendment (2009 Measures No. 1) Act 2009* (item 102) apply in relation to income years starting on or after 1 July 2009, and yet the payments of the income subsidy (from about February to April 2009) do not fall within that income year.

Financial implications

The Explanatory Memorandum notes that this measure will not have a financial impact.[77]

Main provisions

Part 1

Item 1 seeks to amend the definition of 'separate net income' in **subsection 159J(6)** of the ITAA 1936, so that it does not include Income Recovery Subsidy payments made for the North Western Queensland floods of January and February 2009.

As noted above, this particular definition has been previously repealed from the ITAA 1936, but amendments in **item 1** will apply to a limited period of time before the repeal.

Item 3 amends **section 51-30** of the ITAA 1997 so that income recovery subsidy payments, claimed after 24 February, but before 13 April, 2009 are exempt income on which personal income tax is not payable.

Part 2 – Sunsetting on 1 July 2011

Part 2 of this schedule reverses the amendments in **Part 1** with apparent affect from 1 July 2011. However, an application provision for this particular part is not in this Schedule. This means that from 1 July 2011, any income recovery subsidy payment for the North West Queensland floods is no longer exempt from income tax.

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76. **Item 6** of **Schedule 5** of the current Bill states that the amendments in **Part 1** of this Schedule apply in relation to the 2008–2009 income year.

77. Explanatory Memorandum, p. 9.

Part 3

Item 6 applies the amendments in **Part 1** to the 2008–2009 year only. This means that these exemptions apply only to income tax assessments for this particular income year.

Schedule 6–Spirit blending

Schedule 6 amends the *Excise Act 1901* (Excise Act) to ensure that the blending of certain high strength neutral (HSN) spirits (i.e. with greater than 10 per cent volume in alcohol) is treated as ‘excise manufacture’, to ensure that imported HSN spirits qualify in the same manner as domestic HSN spirits for the concessional spirits regime under the Excise Act. Amendments in this schedule also give the Commissioner for Taxation the power to exclude certain activities from being treated as classified as ‘excise manufacture’ by legislative instrument.[78]

Background

Items 3.5 to **3.8** in the table in the Schedule to the Excise Act operate to apply a ‘free’ rate of excise duty to certain high strength neutral (HSN) spirits used generally for specified industrial, manufacturing, scientific, medical, veterinary or educational purpose.

Imported HSN spirits are subject to excise duty on importation under the *Customs Tariff Act 1995* unless they are to be used as an input in ‘excise manufacture’ (i.e. the production or manufacture in Australia of goods specified in the table in the Schedule to the Tariff Act).[79]

If importers of HSN spirits blend or mix their product with a domestic HSN spirit, then the mixed product enters the domestic market at a ‘free’ (or concessional) rate.[80]

Basis of policy commitment

This measure was announced in the Mid Year Economic and Fiscal Outlook 2009–10.[81]

Policy development

Treasury released an exposure draft of the proposed amendments on 12 October 2009.[82] To date, Treasury has not released comments received on this material.

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78. Thomson Reuters, op cit., p. 2192. Any legislative instrument is subject to the Parliamentary disallowance procedures in Part 5 of the *Legislative Instruments Act 2003*.
79. Ibid.
80. Explanatory Memorandum, p. 83.
81. Australian Government, *Mid Year Economic and Fiscal Outlook 2009–10*, op. cit., p. 134.

Pros and cons

The main purpose of the proposed amendments appears to be to give greater certainty to the excise-free status of imported HSN spirits used in excise manufacture.

Financial implications

The Explanatory Memorandum notes that this measure will not have a financial impact.[83]

Main provisions

Item 1 inserts **new section 77FM** into the Excise Act, having the following effects:

- spirit blending is to be regarded as manufacture for the purposes of the Excise Act, and
- the Chief Executive Officer of Customs may make a legislative instrument specifying that in some circumstances spirit blending is not spirit manufacture for the purposes of the Excise Act.

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82. Treasury, *Excise manufacture and spirits: exposure draft legislation and draft explanatory material*, 12 October 2009, viewed 8 January 2010, http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=1639

83. Explanatory Memorandum, p. 10.

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