

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.

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

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.

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 fund¹⁶ (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.

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

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

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.

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

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

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.

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.

