

2014

EXPOSURE DRAFT

TAX AND SUPERANNUATION LAWS AMENDMENT (2014 MEASURES NO. 7)
BILL 2014: PROVIDING CERTAINTY FOR SUPERANNUATION FUND
MERGERS

EXPLANATORY MATERIAL

Chapter

Providing certainty for superannuation fund mergers

Outline of chapter

1.1 Schedule # of the Bill will amend the *Income Tax Assessment Act 1997* (ITAA 97) to ensure that individuals whose superannuation benefits are involuntarily transferred from one superannuation plan to another plan without their request or consent are not disadvantaged through the application of the proportioning rule to their benefits. Schedule # of the Bill will also amend the *Taxation Administration Act 1953* (TAA) to remove the need for a roll-over benefit statement to be provided to an individual whose superannuation benefits are involuntarily transferred.

Context of amendments

1.2 An individual's superannuation benefits may be transferred from one superannuation plan to another plan in circumstances that may be outside the control of the individual, including as a result of a merger under a successor fund arrangement.

1.3 The proportioning rule is designed to remove an individual's capacity to reduce their potential tax liability by manipulating the tax components of their superannuation benefits. The rule determines the tax free and taxable components of a superannuation benefit, and is applied when a benefit is paid from a superannuation plan, including by way of a roll-over.

1.4 The proportioning rule applies to transfers between superannuation plans (a superannuation fund, approved deposit fund or retirement savings account) that are made without a specific request from or consent of an individual ('involuntary transfer'), as these transfers are payments of superannuation benefits and are also roll-over superannuation benefits if the transfers are between complying superannuation plans. An involuntary transfer of a superannuation benefit may occur under a successor fund arrangement, where there is a compulsory transfer of an accrued default amount to a MySuper product in another complying

superannuation plan, or where a transfer is made to an eligible rollover fund.

1.5 In some circumstances an individual may be potentially disadvantaged through the application of the proportioning rule when their benefits are involuntarily transferred into a new plan.

1.6 Where an individual's benefit is paid from a superannuation interest not supporting an income stream, the tax free component of the interest is limited to the value of the interest at the time the transfer is made. In circumstances where the value of the interest was less than the contributions and crystallised segments of the interest in the original plan (because the plan had incurred investment losses after the individual had made personal contributions to the plan) an individual could not recoup this difference in the tax free component of the new plan. By contrast, if the individual had remained in the original plan, they could recoup this difference through an increase in the value of their interest from future plan earnings. The amount of tax free component of the interest could then be greater when a benefit was paid from the plan.

1.7 These amendments will ensure that where an individual's benefits in a superannuation plan are involuntarily transferred to a new superannuation plan, the individual will remain in the same taxation position, as if the transfer had not occurred. This will also remove a possible impediment to a fund merger or rationalisation arrangement proceeding that is in the interests of superannuation plan members, depositors, or account holders as a whole, even if it would not otherwise be in the interest of a given individual member, depositor or account holder.

1.8 The amendments will also remove the unnecessary burden for the original plan provider to give a roll-over benefit statement to each former member, depositor or account holder affected by the transfer. These individuals will still receive information on the transfer in accordance with disclosure obligations under the *Corporations Regulations 2001*.

Summary of new law

1.9 Schedule # amends the ITAA 97 to ensure that where an individual's benefits are involuntarily transferred to a new superannuation plan the individual will remain in the same taxation position, as if the transfer had not occurred. For superannuation interests not supporting an income stream, the new superannuation plan will recognise the full value of the individual's contribution segment and crystallised segment in the

original plan, immediately prior to the benefit payment. In the case of a superannuation interest supporting an income stream, the income stream commenced in the new plan will retain the same tax components as the income stream in the original plan.

1.10 Amendments to the TAA will also remove the need for the original superannuation plan to give a roll-over benefit statement to each former member, depositor or account holder affected by the transfer.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<p>The amount of the contributions segment and the crystallised segment of an individual's superannuation interest will no longer be limited to the value of their interest at any particular time.</p>	<p>The amount of the contributions segment and the crystallised segment of an individual's superannuation interest is limited to the overall value of their superannuation interest at any particular time.</p>
<p>When an involuntary rollover superannuation benefit for a superannuation interest not supporting an income stream is paid to a new superannuation plan, the contributions segment in the new plan will include an amount equal to the contributions and crystallised segment in the original plan immediately before the involuntary roll-over superannuation benefit payment.</p>	<p>When an involuntary rollover superannuation benefit for a superannuation interest not supporting an income stream is paid to a new superannuation plan, the contributions segment in the new plan equals the tax free component of the involuntary roll-over superannuation benefit.</p>
<p>If an involuntary roll-over superannuation benefit is paid from a superannuation interest supporting an income stream, the proportions of the tax free and taxable components of the income stream commenced in the new plan will be the same as the income stream in the original plan.</p>	<p>If an involuntary transfer is paid from a superannuation interest supporting an income stream, the income stream ceases immediately prior to the transfer. The law does not provide clear guidance on how the tax free and taxable components of the benefit payment to the new plan are determined.</p>

Transferring superannuation plans will not be required to give roll-over superannuation benefit statements to members, depositors, or account holders for involuntary roll-over superannuation benefits.	Transferring superannuation plans are required to give a roll-over benefit statement to each former member, depositor or account member of the plan.
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Detailed explanation of new law

1.11 All superannuation benefit payments, including rollover superannuation benefit payments may be made up of two components, a tax free component and a taxable component.

1.12 The proportioning rule (section 307-125 of the ITAA 97) specifies how to calculate the tax free and taxable components for most superannuation benefits.

1.13 For benefits paid from a superannuation interest not supporting an income stream, the value of the interest and its components must be worked out at the time the benefit is paid. For benefits paid from an interest supporting an income stream, the value of the interest and its components must be determined at the time the income stream commenced.

1.14 Under section 307-210 of the ITAA 97, the tax free component of a superannuation interest is so much of the value of the interest as consists of the contributions segments and the crystallised segment of the interest. The contributions segment of the interest will include the tax free component of any roll-over superannuation benefits that have been paid into the interest from another superannuation plan (see subsection 307-220(2) of the ITAA 97).

1.15 The taxable component of a superannuation interest is the value of the interest less the tax free component of the interest (see section 307-215 of the ITAA 97).

1.16 The application of the proportioning rule to certain involuntary roll-overs could disadvantage some individuals.

1.17 In the case of an involuntary transfer of benefits from an interest not supporting an income stream, where the sum of the contributions

segment and the crystallised segment of the interest exceeds the value of the interest at the time of a transfer, an individual's new tax free component in the receiving plan will be limited to the value of their interest in the original plan at the time of the transfer. This could occur where the original plan experienced investment losses after personal contributions were made to the plan. The amount by which the sum of the segments exceeds the value of the interest in the original plan would not be recouped by earnings in the receiving plan. By contrast, if there had been no involuntary transfer, the individual could recoup this excess through new earnings to the plan. The amount of tax free component of the interest could then be greater when a benefit is paid from the plan.

Example 1.1– Loss of a tax free component through an involuntary roll-over under the current law

Since 1 July 2007, Harry has made \$500,000 in personal contributions, from his after tax earnings, to Village Super. Harry has not commenced an income stream with Village Super. Harry's superannuation interest in Village Super therefore has a possible maximum contributions segment of \$500,000.

The trustees of Village Super agree with the trustees of Civic Super to merge Village Super into Civic Super on 1 July 2015. Before the merger the two trustees also agree that Civic Super will provide members with equivalent rights to those in Village Super. At the merger date, Harry's interest in Village Super is valued at only \$450,000.

The roll-over of Harry's benefits from Village Super to Civic Super, on 1 July 2015, would result in Harry losing \$50,000 of the value of his contributions segment in Village Super. While the tax free component of the roll-over superannuation benefit paid to Civic Super would be the full amount of that benefit, this benefit is only \$450,000, not the full \$500,000 that could potentially be tax free. As a result, his contributions segment in Civic Super, following the merger is only \$450,000.

If Harry's benefits had remained in Village Super his contributions segment could have remained at \$500,000 and might have been recouped by future earnings in Village Super.

1.18 In the case of an involuntarily transfer of benefits from a superannuation interest supporting an income stream immediately before the transfer, the income stream in the original plan ceases before the transfer is paid. The current law does not provide clear guidance on how the tax free and taxable components of the benefit paid to the receiving plan as part of an involuntary transfer are determined as existing

paragraph 307-125(3)(c) of the ITAA 97 only applies to commutations. This contrasts with the situation where an income stream is commuted in the original plan (through a roll-over request from the income stream holder) and the commuted balance is used to commence a new pension in a receiving plan. In this situation the tax free and taxable component proportions of the income stream paid from the receiving plan would be the same as the proportions for the income stream in the original plan.

1.19 Schedule # introduces a new definition to identify a particular form of a roll-over superannuation benefit being an involuntary roll-over superannuation benefit. An involuntary roll-over superannuation benefit is: a payment transferring an interest of a member of a superannuation fund, a depositor with an approved deposit fund or holder of a retirement savings account (RSA) to a successor fund (other than a self managed superannuation fund); or a payment transferring an accrued default amount of a member from a complying fund to a MySuper product through an election made under the *Superannuation Industry (Supervision) Act 1993* (SISA); or a payment for the issue of a superannuation interest in an eligible rollover fund under section 243 of the SISA. The three circumstances involve a transfer of an individual's benefits between superannuation plans made without a request from the individual concerned. [*Schedule #, items 1 and 9*]

1.20 The schedule also replaces the current definition of successor fund in subsection 955-1(1) of the ITAA 97 with a new definition that includes a transfer of a superannuation interest of a depositor with an approved deposit fund to another superannuation fund, approved deposit fund or RSA (being the successor fund). [*Schedule #, item 10*]

1.21 The amendments remove the limitation that the crystallised and the contributions segment of a superannuation interest cannot individually or cumulatively exceed the value of the interest. The tax free component of a superannuation interest in section 307-210 of the ITAA 97 remains limited to so much of the value of the interest as consists of the contributions segment and crystallised segment. [*Schedule #, items 6 and 7*]

1.22 The note to section 307-210 of the ITAA 97 has been replaced with new sub-section 301-210(2) confirming how the tax free component of an interest is reduced when a superannuation benefit is paid from the interest. This is done by firstly reducing the crystallised segment of the interest (but not below zero) by an amount equal to the tax free component of the superannuation benefit. If any of amount of the tax free component of the superannuation benefit remains after the reduction of the crystallised segment (if the interest has one), then the contributions segment is reduced by this remaining amount. This has the effect of reducing the tax free component of the interest by the amount of the tax free component of the benefit. [*Schedule #, items 4,5, and 8*]

1.23 The method for determining the contributions segment of a superannuation interest in section 307-220 of the ITAA 97 is modified to disregard the tax free component of an involuntary roll-over superannuation benefit paid into the interest from an earlier interest (other than one supporting an income stream). An amount equal to the sum of the contributions segment and crystallised segment of the earlier interest is then included in the contributions segment of the new interest. [*Schedule #, item 6*]

1.24 The effect of these amendments, for an involuntary roll-over of an interest not supporting an income stream, is that the tax free component of the new interest will not be limited by the value of the earlier interest in the original plan immediately before the involuntary roll-over occurred. In circumstances where investment losses in the original plan are effectively 'recovered' in the receiving plan, any tax free component otherwise lost through the involuntary roll-over could then be recouped on a benefit payment from the new plan.

Example 1.2 - Treatment of the contributions segment through an involuntary roll-over under the new law

Since 1 July 2007, Harry has made \$500,000 in personal contributions, from his after tax earnings, to Village Super. Harry has not commenced an income stream with Village Super. Harry's superannuation interest in Village Super has a possible maximum contributions segment of \$500,000 and a crystallised segment of zero.

The trustees of Village Super agree with the trustees of Civic Super to merge Village Super into Civic Super on 1 July 2015. Before the merger the two trustees also agree that Civic Super will provide members with equivalent rights to those in Village Super. As at 1 July 2015, Harry's interest in Village Super is valued at only \$450,000.

On 1 September 2015, Harry decides to retire and withdraw all his superannuation benefits from Civic Super. On 1 September 2015, the value of Harry's interest in Civic Super has risen to \$490,000. No contributions have been made to Civic Super since the merger by Harry or on his behalf.

Under the new law Harry's contributions segment in the new fund would be \$500,000. That is it would consist of the sum of the contributions segment and the crystallised segment, of Harry's earlier interest in Village super immediately before the merger with Civic Super. The tax free component of Harry's benefit payment on retirement would therefore be the full amount of the benefit payment being \$490,000.

By contrast, under the old law, Harry's contribution segment would have been limited to the value of the tax free component of the benefit paid from Village Super into Civic Super, being \$450,000. Harry's retirement payment would have therefore consisted of a \$450,000 tax free component and a residual \$40,000 taxable component.

1.25 Similarly, under the amendments, where an involuntary roll-over superannuation benefit is paid from a superannuation interest that was supporting a superannuation income stream immediately before the benefit was paid, the new income stream paid from the receiving plan will retain the same proportion of tax free and taxable components as the original income stream. This will ensure there is no the disadvantage to an individual in receipt of an income stream because of an involuntary roll-over. *[Schedule #, item 3]*

1.26 The amendments will also remove the need for the provider of a transferring plan to provide a roll-over benefit statement to each former member, depositor or account holder. These individuals will still receive information on the transfer in accordance with disclosure obligations under the *Corporations Regulations 2001*. They may also request information on the roll-over from their original plan under section 390-15 of Schedule 1 to the TAA. *[Schedule #, item 11]*

Application and transitional provisions

1.27 The amendments made by this schedule apply in relation to superannuation benefits paid on or after 1 July 2015. *[Schedule #, item 11]*

