

Taxation relief to support the implementation of Stronger Super

Proposals Paper
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CONSULTATION PROCESS

Request for feedback and comments

We invite interested parties to lodge written submissions on the design of this measure.

We also encourage the identification of any other issues, including interaction issues with other parts of the tax law that may be relevant to the design of these measures. While submissions may be lodged electronically, by post or by facsimile, electronic lodgement is preferred.

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FOREWORD



I am very pleased to release this paper on the Government's proposal to provide taxation relief to support the implementation of the Government's package of reforms of the superannuation system known as 'Stronger Super'.

The proposed relief will ensure that tax considerations are not an impediment to superannuation funds seeking to merge and consolidate in response to the Stronger Super reforms. The taxation relief will also ensure that default members of superannuation funds are not adversely affected if their superannuation benefits and relevant assets are transferred under the MySuper reforms.

This proposals paper sets out the implementation and design details of the proposed taxation relief and I encourage interested parties to participate in the consultation process.

The Hon Bill Shorten MP

Minister for Financial Services and Superannuation and Minister for Employment and Workplace Relations

SUMMARY

On 29 May 2009, the Government commissioned the Super System Review (the Review), chaired by Jeremy Cooper, to make recommendations to ensure the superannuation system focused more sharply on operating in the best interests of members. The Review's final report was handed to the Government on 30 June 2010.

In response to the Review, the Government announced a package of reforms of the superannuation system called 'Stronger Super'. The key elements of the reforms are:

- the introduction of MySuper, a new simple, cost-effective default superannuation product;
- making the process of everyday transactions easier, cheaper and faster through the SuperStream package of measures; and
- clearer duties for directors of superannuation trustee boards and other measures to improve the governance and integrity of the superannuation system.

Several aspects of the Stronger Super reforms will put pressure on superannuation funds to improve their competitiveness or reassess their viability in the absence of merging with another entity. The transfer of assets by way of a merger can result in either a tax liability or the extinguishment of tax losses. These losses have arisen from recent unfavourable financial market conditions. Tax considerations are a major impediment to mergers as trustees of superannuation funds must consider the adverse tax impacts on members' accounts. Although a merger may be in the long-term interest of members, the immediate reduction in members' account balances may preclude this from happening.

The introduction of MySuper will require superannuation funds not wishing to offer MySuper products to transfer existing default member benefits and relevant assets to another superannuation fund. If such transfers of funds' assets create a capital gains tax liability, the affected members could be adversely impacted.

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

1. PURPOSE

This proposals paper forms the basis for consultation on the temporary taxation relief and sets out, in broad terms the way they may be implemented. The purpose of this proposals paper is to provide interested parties with an opportunity to comment on the policy design of these changes.

All legislative references in this paper refer to the *Income Tax Assessment Act 1997*. The term 'complying superannuation fund' is used in this paper as a shorthand to cover both a complying superannuation fund and a complying approved deposit fund (ADF).

2. BACKGROUND

2.1 OPERATION OF EXISTING LAW

Where superannuation funds merge, there is usually a change in legal and underlying ownership of the transferred assets. The transfer of assets from one superannuation fund to another will result in the realisation of capital gains or capital losses for the transferring fund in the form of capital gains tax (CGT) event A1 (section 104-10) or CGT event E2 (section 104-60). Following this asset transfer and the transfer of members' benefits to the receiving fund, the transferring fund will generally be wound up in a merger.

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

Superannuation funds typically credit the tax value of unrealised losses and unused losses to the account balances of members. This recognises the future offsetting tax benefit that unrealised or unused capital losses have against future capital gains (and similarly for revenue losses). Where the tax value of unrealised losses has been included in the valuation of members' accounts, then the merger of their superannuation fund or transfer of their members' interests from one fund to another will lead to a reduction in their account balances. This can act as an obstacle to the superannuation fund merging with another fund because the trustee, in contemplating a potential merger, has to take this reduction of members' account balances into consideration.

2.2 PREVIOUS LOSS RELIEF

The previous loss relief, which applied from 24 December 2008 to 30 September 2011, provided an optional CGT roll-over for capital losses and revenue losses arising from a complying superannuation fund's merger with an Australian Prudential Regulatory Authority (APRA) regulated superannuation fund with at least five members. Without the relief such losses would have been extinguished when a merging fund is wound up, which would have affected the account balances of members of that fund.

The previous loss relief covered mergers involving pooled superannuation trusts (PSTs), and the complying superannuation businesses of life insurance companies. The transfer of previously realised

net capital losses and revenue losses, including prior year losses, was also provided under the previous loss relief.

The previous loss relief was provided in response to the uncertain conditions in the global economy and the financial market turmoil that existed at the time to ensure the efficiency and robustness of the superannuation system.

3. THE STRONGER SUPER REFORMS

In response to the Review into the governance, efficiency, structure and operation of Australia's superannuation system, the Government announced a package of reforms of the superannuation system called 'Stronger Super'.

On 21 September 2011, key design aspects of the Stronger Super reforms were announced. Public consultation was conducted with key stakeholders on the CGT consequences that may directly arise from transitioning to Stronger Super. The open public consultation concluded on 21 October 2011.

Key elements of Stronger Super that are related to the consideration of tax consequences include:

- the introduction of MySuper products to replace the existing default funds offered by superannuation entities;
- superannuation fund trustees will be required to actively consider whether they have sufficient scale (in terms of both assets and members) to provide optimum benefits to MySuper members; and
- the 'SuperStream' reforms to enhance the 'back office' of superannuation.

3.1 MYSUPER PRODUCTS

The introduction of MySuper products from 1 July 2013 will increase standards applicable to default superannuation products by imposing heightened duties on trustees to act in the best financial interests of members.

From 1 October 2013, all contributions on behalf of members that have not made a choice of fund must be placed into a MySuper product. Amounts accrued by these members before 1 October 2013 will have to be transferred to an authorised MySuper product in the same fund by 30 June 2017. However, where a fund chooses not to offer a MySuper product, it will have a legislative requirement to transfer members' benefits and relevant assets to a fund that does offer a MySuper product by 30 June 2017.

The introduction of MySuper is expected to encourage, and in some cases necessitate, superannuation fund mergers and transfers of members' benefits and relevant assets to another fund.

3.2 IMPORTANCE OF INCREASED SCALE FOR SUPERANNUATION FUNDS

Increased size of superannuation funds is a significant factor that enables funds to provide a range of benefits to members, including lower fees through administrative efficiency and greater returns and diversification of investment through additional investment weight.

To encourage additional scale, MySuper trustees will have a duty to actively consider whether their MySuper products and their funds as a whole have sufficient investment scale (in terms of assets) or administrative scale (in terms of members) on their own to ensure the financial interests of their MySuper members are not disadvantaged relative to other MySuper product beneficiaries in other funds.

3.3 SUPERSTREAM REFORMS

The implementation of the SuperStream reforms will require superannuation funds (and employers) to upgrade their information technology systems to comply with the new mandatory data and e-commerce data requirements. Costs associated with the upgrade of systems may be substantial.

The mandatory costs associated with the SuperStream reforms are likely to influence potential merger decisions.

4. TAX PROPOSALS TO SUPPORT THE IMPLEMENTATION OF STRONGER SUPER

The proposals to support the implementation of Stronger Super have two objectives:

- to ensure income tax considerations do not prevent mergers of superannuation funds; and
- to ensure there are neutral tax consequences for superannuation funds not wishing to offer MySuper products to transfer existing members' benefits and relevant assets to a fund that does offer a MySuper product.

To achieve these objectives the proposals will provide merger relief and relief for mandatory transactions required under the MySuper reforms.

TAXATION RELIEF FOR MERGING SUPERANNUATION FUNDS

The taxation relief for merging superannuation funds will be provided on generally the same terms and conditions as the previous loss relief for capital losses and revenue losses relating to mergers of superannuation funds. However, there will be some other terms and conditions for the proposed taxation relief including:

- an optional asset roll-over for capital gains for all superannuation fund mergers eligible for the proposed loss relief;
- losses that are transferred to the receiving entity will be treated as having been made in the income year that they were transferred;

- realised losses from disposals of assets in the 12 months prior to a merger to an entity that becomes a receiving entity in the merger, where those assets are still held by that entity will not be able to be transferred to that entity;
 - This will prevent direct disposals of assets from the transferring entity to the receiving entity. Purchases of assets that were owned by the transferring entity on the market by the receiving entity will not be affected.
- the complete exclusion of self-managed superannuation funds from the relief.

The proposed optional loss relief will apply from 1 June 2012 to 1 July 2017. This period broadly coincides with the period for superannuation funds to undertake the preparation required to transition to the Stronger Super reforms.

MYSUPER RELIEF

Optional roll-over for capital gains and capital losses will be provided to facilitate the mandatory transfer of members' benefits and relevant assets to a fund that offers a MySuper product. Optional loss relief will also be available for losses that are related to the transfer of members' benefits.

This proposed optional roll-over will be available from 1 July 2013 to 1 July 2017. These dates broadly coincide with the date of introduction of MySuper and the deadline for the transfer of certain specified amounts to a MySuper product.

4.1 TAXATION RELIEF TO FACILITATE MERGERS OF SUPERANNUATION FUNDS

An eligible complying superannuation fund may choose, where there is an arrangement to merge the fund with another complying superannuation fund with five or more members, to:

- transfer unused capital losses and/or revenue losses that were realised prior to a merger (including prior year losses); and
- roll over capital gains and capital losses and revenue losses (and revenue gains in particular circumstances) on transferred assets.

This choice by an eligible complying superannuation fund will be achieved through the provision of a loss transfer and an asset roll-over.

Superannuation funds will not be required to be in an overall capital loss position to be able to be able to roll over capital gains on transferred assets.

4.1.1 Entities eligible for the taxation relief

The proposed taxation relief for mergers of superannuation funds will generally apply to the same entities that were able to access the previous loss relief.

As such, the entities that may be eligible for the proposed relief are: complying superannuation funds, complying ADFs, a life insurance company or a PST. For a life insurance company or a PST to be eligible for the proposed relief, a complying superannuation fund needs to hold assets via a complying superannuation/first home saver account (FHSA) policy or hold assets via units in a PST.

Exclusion of self-managed superannuation funds (SMSFs)

The Stronger Super reforms will not place pressure on SMSFs to merge and consolidate. Further, the MySuper requirements will not be applicable to SMSFs. Therefore, extending the taxation relief for mergers to SMSFs or providing the MySuper tax relief for SMSFs is not warranted.

4.1.2 Conditions to transfer losses

The proposed loss transfer relief will require the same conditions for an entity to choose the loss transfer in respect of an arrangement to merge superannuation funds as applied under the former loss relief.

4.1.3 Certain realised losses will not be able to be transferred

To ensure integrity around the loss transfer, certain realised losses will not be able to be transferred. Realised losses from disposals of assets to a merger entity including a PST or life insurance company in the 12 months prior to a merger, where those assets are still held by that entity will not be able to be transferred as realised losses to that entity. This ensures that the proposed loss relief will not apply to losses attributable to transfers of assets within the 12 months prior to a merger where those assets were directly transferred to the other merger entity.

This would not stop merging entities from engaging in normal trading activities. It would only apply where assets that a transferring entity sells or transfers to the other relevant merger entity. For example, it would not apply if the transferring entity sold shares in a particular company through the ASX and realised losses on the sale and the other relevant merger entity purchased those shares through the ASX.

For consistency, during the merger time the transferring entity will not be able to realise a loss and not choose roll-over and then transfer the realised loss and the asset on which the loss was made to another relevant merger entity.

4.1.4 Use of transferred losses

Revenue and capital losses transferred to a receiving entity as part of a merger will be treated as having been made by the receiving entity in the income year that they were transferred. These losses will be able to be used by the receiving entity to offset income or gains (depending on whether a revenue loss or capital loss had been transferred) in the income year of transfer and future income years. This will mean that the receiving entity will be unable to use the transferred losses to offset gains in earlier income years.

4.1.5 Conditions for the asset roll-over

In general, the conditions that applied for an entity to choose the asset roll-over under the previous loss relief will apply to the proposed relief for asset roll-over.

As noted earlier, capital gains realised on asset transfers will be able to be rolled over for all eligible superannuation fund mergers.

Mergers that have a completion time of 1 July 2017 will be accommodated in relation to the condition that requires mergers to take place within a single income year.

4.1.6 Choosing the form of the asset-roll-over

Under the previous loss relief, entities eligible for the asset roll-over may, depending on their circumstances, have been able to choose between two methods for executing the roll-over. The two methods available were:

- the global asset approach; and
- the individual asset approach.

If an entity was in a net capital loss position in relation to the transferred assets for the current year, it may have chosen either the global asset approach or the individual asset approach. If the entity was not in a net capital loss position in relation to transferred assets it could only have chosen the individual asset approach.

Under the global asset approach all assets had to be rolled over from a transferring entity to the receiving entity. Under the individual asset approach a transferring entity may have disregarded all the capital losses it realised, or it may have chosen to disregard some or none of its capital losses; any capital gains that had been realised on transferred assets were not able to be disregarded.

Similar rules applied in the previous loss relief for the transfer of revenue assets.

Under the proposed asset roll-over, assets with a capital gain will be able to be rolled over regardless of a transferring entity's net capital loss position. Therefore, for CGT assets it may no longer be necessary to provide a global asset and individual asset approach but provide instead a typical optional CGT asset roll-over for capital gains and capital losses. However, the global asset approach and the individual asset approach will still be required for revenue assets.

4.2 TAXATION RELIEF TO FACILITATE THE MANDATORY REQUIREMENTS TO TRANSFER MEMBERS AND ASSETS TO A FUND THAT OFFERS A MYSUPER PRODUCT

The introduction of MySuper from 1 July 2013 will require by 1 July 2017 superannuation funds not wishing to offer MySuper products to transfer members, their benefits and relevant assets to another superannuation fund offering a MySuper product. It is expected that the assets transferred will reflect an appropriate proportion of the total assets held for all members of the transferring fund. If such compulsory transfers create a CGT liability (via the necessary transfers of assets), these members could be worse off. As part of the transfer of existing default members and their benefits it may also be necessary to transfer a share of unused capital and revenue losses to the receiving fund.

Optional roll-over for capital gains and capital losses will be provided for transfers of assets which must be made from a fund that chooses not to offer a MySuper product to another fund that does offer a MySuper product. Optional loss relief would also be available to permit the transfer of losses that reflected the tax value of losses incorporated in members' account balances.

The fund that has to transfer its default members may hold assets directly or it may hold assets indirectly through holding life insurance policies or units in a PST. As such, when it transfers its default members to the other fund it may have to request the life insurance company or PST to transfer assets to the value of the policy or attributable to the units in the PST to the other fund, another PST or life insurance company. The transfer of these assets will require a standard CGT roll-over so that any capital gains or capital losses are 'rolled over' to the receiving entity.

The taxation relief to facilitate these mandatory requirements will apply from 1 July 2013 to 1 July 2017. This application period broadly coincides with the introduction of MySuper and the deadline for the transfer of a fund's existing default members' interests to a MySuper product.

This roll-over and loss relief will apply only where there is no merger of the relevant superannuation funds as the merger roll-over described above would apply to a merger.

4.2.1 Optional roll-over under MySuper

Conditions for the roll-over

The standard conditions that usually apply to roll-overs in Division 126, which covers same asset roll-overs, will apply to the optional roll-over for capital gains and capital losses for those assets transferred under the MySuper requirements. The conditions for the MySuper roll-over will include:

- the transferring and receiving entity must be a complying superannuation fund, life insurance company with complying superannuation/FHSA business or PST;
- the complying superannuation fund transferring assets must not be merging with the fund receiving the default members; and
- the transfer of assets must occur on or after 1 July 2013 and before 2 July 2017.

Consequences of choosing the roll-over

The consequences for the transferring entity in choosing the optional roll-over will result in capital gains or losses on the transferred assets being disregarded.

The consequences for the receiving entity will be:

- if the transferred asset was acquired by the transferring entity on or after 20 September 1985, the first element of the asset's cost base will be equal to the transferring entity's cost base at the time of transfer.
- if the transferred asset was acquired by the transferring entity before 20 September 1985, the receiving entity will be taken to have acquired the asset before that day.
- for the purposes of the discount capital gain under section 115-25, the receiving entity will be taken to have acquired the asset on the same day as it was acquired by the transferring entity.

4.2.2 Conditions for the optional loss transfer under MySuper

The conditions for the optional loss transfer will include:

- the transferring and receiving entity will have to be a complying superannuation fund, life insurance company with complying superannuation/FHSA business or PST; and
- the transferring entity will not be merging with the receiving entity.

The losses transferred to the receiving entity will be treated as having been made in the income year that they were transferred.

Realised losses from disposals of assets to a receiving entity in the 12 months prior to a merger where those assets are still held by that entity will not be able to be transferred as realised losses to that entity.

The transferring entity will not be able to realise a capital loss and not choose roll-over and then transfer the realised loss and the asset on which the loss was made to a receiving entity.

5. SUMMARY OF TAX OUTCOMES UNDER PROPOSED RELIEF

Assets transferred or losses already realised	Tax outcome
Revenue assets transferred at the time of merger	Deferral of tax outcome by a receiving entity until a later dealing of the asset for all assets under the global asset approach or deferral only for loss-making assets under the individual asset approach.
Losses on revenue assets realised prior to a merger or transfer including prior year losses	Revenue losses will be able to be transferred to a receiving entity. Transferred losses will be treated as having been made by a receiving entity on the date of transfer. The loss will not be transferable in the case of mergers where the asset was transferred to a receiving entity in the 12 months prior to the merger or transfer. Transferring entities will not be able to choose to realise a loss on an asset that is transferred to a receiving entity and then transfer that loss to the receiving entity; such losses will have to be 'rolled over' to the receiving entity.
CGT assets transferred as part of a merger or transfer of default members	Deferral of tax outcome until a later dealing of the asset by a receiving entity.
Losses on CGT assets realised prior to a merger or transfer including prior year losses	CGT losses will be able to be transferred to a receiving entity. Transferred losses will be treated as having been made by a receiving entity on the date of transfer. The loss will not be transferable in the case of mergers where the asset was transferred to a receiving entity in the 12 months prior to the merger or transfer. Transferring entities will not be able to choose to realise a loss on an asset that is transferred to a receiving entity and then transfer that loss to the receiving entity; such losses will have to be 'rolled over' to the receiving entity.