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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

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TAX LAWS AMENDMENT (2009 MEASURES No. 6) BILL 2009

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EXPLANATORY MEMORANDUM

(Circulated by the authority of the  
Treasurer, the Hon Wayne Swan MP)







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# Glossary

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The following abbreviations and acronyms are used throughout this explanatory memorandum.

<i>Abbreviation</i>	<i>Definition</i>
APRA	Australian Prudential Regulation Authority
ADF	approved deposit fund
CGT	capital gains tax
Commissioner	Commissioner of Taxation
DGRs	deductible gift recipients
Excise Act	<i>Excise Act 1901</i>
Excise Tariff	<i>Excise Tariff Act 1921</i>
FHSA	First Home Saver Account
GST	goods and services tax
ITAA 1936	<i>Income Tax Assessment Act 1936</i>
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
IT(TP)A 1997	<i>Income Tax (Transitional Provisions) Act 1997</i>
MIT	managed investment trust
PSTs	pooled superannuation trusts
SIS Act 1993	<i>Superannuation Industry (Supervision) Act 1993</i>
SIS Regulations 1994	<i>Superannuation Industry (Supervision) Regulations 1994</i>
SMSFs	self-managed superannuation funds



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## ***General outline and financial impact***

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

Schedule 1 to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to repeal the exception to capital gains tax (CGT) events E1 and E2 widely known as the ‘trust cloning’ exception. Schedule 1 also provides a limited CGT roll-over for the transfer of assets between trusts with the same beneficiaries each of which has the same interests in each trust.

Schedule 1 clarifies that a mere change of the trustee of a trust does not change the entity that is the trustee for the purposes of the ITAA 1997 and the *A New Tax System (Goods and Services Tax) Act 1999*.

***Date of effect:*** The amendments apply to CGT events happening on or after 1 November 2008.

***Proposal announced:*** The then Assistant Treasurer and Minister for Competition Policy and Consumer Affairs announced the repeal of the trust cloning exception in Media Release No. 092 of 31 October 2008. He subsequently announced in Media Release No. 048 of 12 May 2009 that the Government would provide a limited CGT roll-over for fixed trusts.

***Financial impact:*** Unquantifiable, but expected to be small.

***Compliance cost impact:*** Low.

### **Loss relief for merging superannuation funds**

Schedule 2 to this Bill removes significant income tax impediments to mergers between complying superannuation funds by permitting the roll-over of capital losses and transfer of revenue losses (including losses realised under the merger and previously realised losses). The loss relief will be available for complying superannuation funds and approved deposit funds that merge with a complying superannuation fund with five or more members. The loss transfer and asset roll-over will preserve the offsetting value of the losses, thereby removing a potential barrier to superannuation fund consolidation.

***Date of effect:*** This measure is available for mergers that occur on or after 24 December 2008 and before 1 July 2011.

***Proposal announced:*** These amendments were announced in the then Minister for Superannuation and Corporate Law's Media Release No. 101, 'Optional CGT Loss Roll Over for Complying Super Funds' on 23 December 2008 and Media Release No. 042, 'Expansion of the Optional CGT Loss Roll Over for Complying Super Funds that Merge' on 29 April 2009.

***Financial impact:*** This measure will have an unquantifiable but small revenue cost.

***Compliance cost impact:*** This measure is expected to have a low overall compliance cost impact, comprised of a low implementation impact and a low decrease in ongoing compliance costs.

## **Exempt annuity business of life insurance companies**

Schedule 3 to this Bill amends the *Income Tax Assessment Act 1997* to clarify the circumstances in which income derived by life insurance companies in respect of immediate annuity business qualifies as non-assessable non-exempt income.

***Date of effect:*** The amendments to rewrite the annuity conditions apply from 1 July 2000. The amendments to ensure that the annuity conditions do not apply to immediate annuity policies that provide for superannuation income streams apply from the 2007-08 income year.

***Proposal announced:*** These amendments were announced in the then Assistant Treasurer and Minister for Competition Policy and Consumer Affairs' Media Release No. 048 of 12 May 2009.

***Financial impact:*** These amendments are expected to have a small but unquantifiable revenue impact.

***Compliance cost impact:*** Low.

## **Deductible gift recipients**

Schedule 4 to this Bill amends the *Income Tax Assessment Act 1997* to update the list of deductible gift recipients (DGRs) to include two new organisations and change the name of one organisation.

Tax deductions are provided to donors to organisations that are endorsed as DGRs, subject to certain conditions. Organisations which do not fall under the general DGR categories may seek specific listing in the income tax law.

**Date of effect:** The dates of effect for these amendments are listed in Table 4.1 and Table 4.2.

**Proposal announced:** These amendments were announced in the *Mid-Year Economic and Fiscal Outlook 2009-10*.

**Financial impact:** This measure will have the following revenue implications.

<i>Organisation</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-12</i>	<i>2012-13</i>
The Green Institute Limited	-\$15,000	-\$30,000	-\$45,000	-\$60,000
United States Studies Centre Limited	-\$1,500,000	-1,537,500	-\$1,575,938	-\$1,615,336
<b>Total</b>	<b>-\$1,515,000</b>	<b>-\$1,567,500</b>	<b>-\$1,620,938</b>	<b>-\$1,675,336</b>

**Compliance cost impact:** Negligible.

## **Income Recovery Subsidy for the North Western Queensland floods**

Schedule 5 to this Bill amends the *Income Tax Assessment Act 1997* to ensure that the Income Recovery Subsidy for the North Western Queensland floods is not subject to income tax.

**Date of effect:** This measure applies retrospectively to amounts received in the 2008-09 income year. The payment could be claimed after 24 February 2009.

**Proposal announced:** The payment was announced as an emergency measure by the Minister for Families, Housing, Community Services and Indigenous Affairs in Parliament on 25 February 2009. The measure was announced in the *Mid-Year Economic and Fiscal Outlook 2009-10*.

**Financial impact:** Nil.

**Compliance cost impact:** Low.

## **Excise manufacture and spirits**

Schedule 6 to this Bill amends the *Excise Act 1901* (the Excise Act) to deem the blending of spirits to produce spirit as excise manufacture for the purposes of the Excise Act. This is necessary for imported high strength neutral spirit, as it currently derives its concessional duty treatment (that is, a 'free' rate of excise duty) from being blended with domestic high strength neutral spirit and entering the excise system. These amendments will preserve the status quo for the concessional spirits regime.

***Date of effect:*** This legislation will apply from the date of Royal Assent.

***Proposal announced:*** This measure was announced in the *Mid-Year Economic and Fiscal Outlook 2009-10* statement released on 2 November 2009.

***Financial impact:*** Nil.

***Compliance cost impact:*** Nil.

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## **Chapter 1**

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

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### **Outline of chapter**

1.1 Schedule 1 to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to repeal the exception to capital gains tax (CGT) events E1 and E2 widely known as the ‘trust cloning’ exception. Schedule 1 also provides a limited CGT roll-over for the transfer of assets between trusts with the same beneficiaries each of which has the same interests in each trust. These amendments apply to CGT events that happen after 31 October 2008.

1.2 Schedule 1 clarifies that a mere change of the trustee of a trust does not change the entity that is the trustee for the purposes of the ITAA 1997 and the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act).

1.3 All references to legislative provisions in this chapter are references to the ITAA 1997 unless otherwise stated.

### **Context of amendments**

1.4 The trust cloning exception allows the creation of a trust over a CGT asset or the transfer of a CGT asset to an existing trust without triggering a CGT taxing point, provided the beneficiaries and terms of both trusts are the same.

1.5 However, this can be used to change ownership of an asset without a CGT taxing point. It potentially allows taxpayers to eliminate tax liabilities on accrued capital gains, undermining equity and the integrity of the tax system.

1.6 The repeal of the trust cloning exception is consistent with the policy principle of taxing capital gains that arise where there is a change in ownership of an asset.

1.7 The CGT regime may provide a CGT roll-over where there is a change in legal ownership of a CGT asset but no change in its underlying ownership. Nevertheless, roll-over is not always provided where there is no change in underlying ownership. Other considerations are important, such as ensuring tax system integrity and the existence of alternatives in the income tax laws.

1.8 Providing a limited CGT roll-over for the transfer of assets between certain trusts with the same beneficiaries is consistent with that approach. This roll-over will ensure that CGT considerations are not an undue impediment to the restructure of those trusts, whilst ensuring that subsequent changes to the manner and extent to which beneficiaries can benefit from the trusts are subject to appropriate tax consequences.

## **Summary of new law**

1.9 Part 1 of Schedule 1 amends the ITAA 1997 by repealing the CGT trust cloning exception.

1.10 Part 2 of Schedule 1 inserts Subdivision 126-G into the ITAA 1997 to provide a limited CGT roll-over for the transfer of assets between certain trusts. Broadly, the effect of the roll-over is to defer the making of any capital gain or capital loss in respect of the asset transfer. The cost base of beneficiaries' interests in the transferring trust is apportioned across their interests in both trusts.

1.11 To be eligible, both trusts must have the same beneficiaries with the same entitlements and no material discretionary elements. Further, the receiving trust must be an 'empty trust', meaning:

- a newly created trust; or
- a trust with no CGT assets other than a small amount of cash or debt.

1.12 Part 3 of Schedule 1 clarifies that a mere change of trustee of a trust does not change the entity that is the trustee for the purpose of the ITAA 1997 and the GST Act.

## Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
The transfer of an asset from one trust to a new or existing trust will trigger a CGT event.	The transfer of an asset from one trust to a new or existing trust that has the same beneficiaries and terms does not trigger a CGT event.
Roll-over may be chosen to disregard any capital gain or capital loss arising from the transfer of an asset from a trust (the 'transferring trust') to a new or existing trust (the 'receiving trust'), provided: <ul style="list-style-type: none"><li>• both trusts have the same beneficiaries with the same entitlements;</li><li>• both trusts have no material discretionary elements;</li><li>• the receiving trust is an 'empty trust'; and</li><li>• no exceptions apply.</li></ul>	The transfer of an asset to a trust typically triggers CGT consequences, unless both trusts have the same beneficiaries and terms.

## Detailed explanation of new law

### Abolishing the trust cloning exception

1.13 The trust cloning exception provides an exception to CGT events E1 and E2.

- CGT event E1 happens where a trust is created over a CGT asset by declaration or settlement.
  - The trust cloning exception to CGT event E1 applies where the trust was created by transferring the asset from another trust and the beneficiaries and terms of both trusts are the same.
- CGT event E2 happens where a CGT asset is transferred to an existing trust.
  - The trust cloning exception to CGT event E2 applies where the asset was transferred from another trust and the beneficiaries and terms of both trusts are the same.

1.14 Schedule 1 repeals the trust cloning exception to CGT events E1 and E2. The other exception to CGT events E1 and E2 (that may apply when an asset is transferred to a relevant trust by a sole beneficiary of the trust that is absolutely entitled to the asset) will be retained. [*Schedule 1, item 1, subsection 104-55(5) and item 2, subsection 104-60(5)*]

***The ‘trustee entity’ provision***

1.15 Subsection 960-100(2) states that the trustee of a trust is taken to be an ‘entity’ consisting of the person who is the trustee, or persons who are the trustees, at any given time. An identical definition exists in subsection 184-1(2) of the GST Act.

1.16 As part of the Tax Law Improvement Project, the Joint Committee of Public Accounts and Audit in *An Advisory Report on the Tax Law Improvement Bill No. 2 1997* (Report 356 of 1998) stated that the interaction of the proposed subsection 104-10(2) with the ‘entity’ provision in subsection 960-100(2) was unclear — that it was possible that a mere change of trustee of a trust was technically a ‘disposal’ and thus a CGT taxing point. The Committee recommended ‘clarification by way of amendment or the addition of guide material’ to the proposed subsection 104-10(2). An amendment was subsequently provided in paragraph 104-10(2)(b).

1.17 In *AXA Asia Pacific Holdings Limited v Commissioner of Taxation* [2008] FCA 1834, Justice Lindgren, in interpreting subsection 184-1(2) of the GST Act, noted that ‘[t]his provision is concerned with continuity irrespective of changes that may occur in the identity of the trustee or trustees from time to time. Under the provisions, a change in the identity of a trustee of a trust does not mark a change in the entity, which is the ‘trustee of [the] trust’.’

1.18 The amendments reflect Justice Lindgren’s interpretation by adding a note to each of the ‘entity’ definitions that confirm that a mere change in the person who is the trustee does not mean there is a new trustee entity for tax purposes. That is, the trustee is still the same entity even if there is a change in the person who holds the office of trustee. [*Schedule 1, items 14 and 15, subsection 184-1(2) of the GST Act; and items 19 and 20, subsection 960-100(2)*]

1.19 Additional notes in CGT events A1, E1 and E2 explain that a mere change of trustee of a trust does not trigger a CGT event. This follows because the entity that is the trustee does not change for tax purposes and so does not give rise to any of these CGT events.

- The definition of disposal for CGT event A1 in subsection 104-10(2) is updated to remove the unnecessary exclusion of a mere change of trustee.

*[Schedule 1, item 16, subsection 104-10(2), item 17, subsection 104-55(1) and item 18, subsection 104-60(1)]*

### **Example 1.1**

Steven and Amanda are the joint trustees of a trust. Steven and Amanda retire and Lachlan is appointed as the replacement trustee. Subsequently, Mikayla Pty Ltd is appointed as an additional trustee to Lachlan. No other changes are made and the property continues to be held on the same trust.

Although there is a change in legal ownership of the trust assets from Steven and Amanda to Lachlan, and then to Lachlan and Mikayla Pty Ltd as joint owners, no CGT event happens in respect of either transaction because there is no change in the entity that is the trustee of the trust for tax purposes.

## **Limited CGT roll-over for certain trusts**

1.20 Schedule 1 also provides an optional CGT roll-over that permits deferral of a capital gain or capital loss made on the transfer of an asset from one trust (the transferring trust) to another trust (the receiving trust).

1.21 The objective of this roll-over is to ensure that CGT considerations are not an undue impediment to the restructure of trusts, whilst ensuring that subsequent changes to the manner and extent to which beneficiaries can benefit from the trusts are subject to appropriate tax consequences. *[Schedule 1, item 9, section 126-220]*

1.22 If the CGT roll-over is chosen, there is also roll-over for any balancing adjustment that arises from the transfer of a depreciating asset (see paragraphs 1.81 to 1.84).

1.23 The CGT roll-over is available if these conditions are met:

- both trusts are eligible (paragraphs 1.26 to 1.41);
- the same beneficiaries have the same interests in both trusts (paragraphs 1.42 to 1.47); and
- no exception applies (paragraphs 1.48 to 1.65).

*[Schedule 1, item 9, subsection 126-225(1)]*

1.24 These conditions aim to ensure that the asset transfer does not change the underlying ownership of the asset, that subsequent changes in ownership are subject to appropriate tax consequences, and that the roll-over cannot be used to undermine the integrity of the tax system.

1.25 This part of the explanatory memorandum discusses these conditions, as well as the consequences for the trustees and beneficiaries if the roll-over applies.

### ***Conditions for roll-over***

#### *Trusts eligible for the roll-over*

1.26 The trustee of the transferring trust and the trustee of the receiving trust must both choose the roll-over in order for it to apply. *[Schedule 1, item 9, subsection 126-225(3)]*

1.27 For the trustees to choose the roll-over, the beneficiaries' interests in each trust must satisfy a number of requirements. Trusts that satisfy these requirements are sometimes referred to as 'fixed trusts'.

- However, the conditions for this roll-over do not employ the existing definition of 'fixed trust' in Schedule 2F to the *Income Tax Assessment Act 1936* (ITAA 1936).
- Furthermore, unlike the trust cloning exception, the roll-over does not require the terms of the two trusts to be precisely the same. However, any differences in terms that result in a significant difference in the nature or extent of beneficiaries' interests will prevent the roll-over applying.

#### CGT event E4 capable of happening to interests

1.28 CGT event E4 must be capable of happening to all the units or interests in each of the trusts. *[Schedule 1, item 9, subsection 126-230(2)]*

1.29 This requirement ensures that so-called discretionary trusts cannot access the roll-over. This is because it is difficult to establish, with any degree of certainty, the real underlying ownership of the assets of a discretionary trust. Therefore, it is equally difficult to test whether that ownership has been maintained.

1.30 An example of a discretionary trust is one where the trustee has a power to appoint the income or capital of the trust to any one of the listed beneficiaries as the trustee sees fit.

Beneficiaries' entitlements not discretionary

1.31 The manner or extent to which each beneficiary of each trust can benefit from the trust must not be capable of being significantly affected by the exercise, or non-exercise, of a power. [*Schedule 1, item 9, subsection 126-230(3)*]

- The requirement must be satisfied by each of the beneficiaries of each of the trusts in respect of each of their membership interests.
- Each beneficiary of the trust must have an interest in the trust that is of a sufficiently definable quality and extent as to be capable of measurement without the exercise or non-exercise of a power (in the sense discussed in *Gartside v Inland Revenue Commissioners* [1968] 2 WLR 277).
- The quality or extent of each beneficiary's interest should not be capable of being defeated or substantively altered by the exercise, or non-exercise, of a power.
- The requirement has regard to the exercise, or non-exercise, of a power by any entity, and not just the trustee of the trust.
- For these purposes, a power includes both trust powers (that is, powers that must be exercised but which allow discretion as to when or how they are exercised) and mere powers (that is, discretions), but does not include trustees' duties. A trustee duty is a thing a trustee must do as prescribed, or refrain from doing, to avoid being in breach of trust (refer discussion in *Jacobs' Law of Trusts in Australia*, 7th ed., Heydon and Leeming at [1606]).

1.32 In effect, beneficiaries' interests should be 'fixed'.

1.33 This requirement is consistent with the objective of ensuring that subsequent changes in 'effective ownership' are subject to appropriate tax consequences. These consequences could be a CGT taxing point (such as on the disposal of an interest) or cost base adjustments (for example, as a result of the value shifting rules applying).

1.34 The following are examples of powers that may, depending on their context, be capable of significantly affecting the manner and extent to which a beneficiary can benefit from a trust:

- a power to appoint the beneficiary's interest in the income or capital to another beneficiary;

- a power to characterise receipts or expenses as income or capital, or to accumulate trust income to capital (unless those otherwise entitled to the income have the same interests in the capital);
- a power to add new beneficiaries (other than by issuing new units or interests in a way that does not significantly affect the value of existing interests);
- a power to appoint any part of the trust property to a new trust with different beneficiaries;
- a power to issue new interests with rights attached that significantly alter the rights or the value of the rights attached to existing interests; and
- a power to amend the trust deed to include a power capable of materially altering a beneficiary's membership interest(s).

1.35 Powers such as the following that merely facilitate the administration of the trust are not regarded as significantly affecting the manner and extent to which a beneficiary can benefit:

- a power to round distributions or other amounts to whole cents per unit or interest;
- a power to alter the manner in which beneficiary entitlements are paid, for example, to determine that they be credited directly to beneficiaries' bank accounts; and
- a power to pay beneficiary entitlements at any time within a prescribed period.

1.36 Similarly, a trustee's right to be reimbursed or exonerated out of the trust property in respect of liabilities and expenses properly incurred in the administration of the trust (see *Chief Commissioner of Stamp Duties for New South Wales v Buckle* (1998) 192 CLR 226) would not be viewed as a power to significantly affect the manner and extent to which beneficiaries can benefit from the trust. Such a right, supported by a lien over the trust assets, simply represents an interest in the trust assets that ranks ahead of the claims of beneficiaries.

### **Example 1.2**

A trust has \$1 billion in assets and has annual income of around \$100 million.

Under the terms of the trust deed, the trustee has the power to issue new units — at an issue price, to persons, and with rights and obligations as determined by resolution. The power could be used, for example, to issue ‘preference’ units that entitle unitholders to the first \$100 million of income of the trust.

This would significantly undermine the value of existing units. Therefore, the extent to which each beneficiary can benefit from the trust is capable of being significantly affected by the exercise, or non-exercise, of a power.

#### Disregard certain powers if their existence does not affect market value

1.37 A trust that is a managed investment trust (MIT) may be eligible for the roll-over notwithstanding that the manner or extent to which a beneficiary can benefit from the trust is capable of being significantly affected by the exercise, or non-exercise, of a power.

1.38 This ‘saving clause’ applies only if the transferring and receiving trusts are both MITs. The savings clause applies if the market value of all of the interests in the MIT would not be significantly different if it were hypothesised that the power did not exist. [*Schedule 1, item 9, subsection 126-230(4)*]

1.39 In other words, beneficiaries’ interests are effectively ‘fixed’ if a hypothetical buyer, acting at arm’s length in an open market and with reasonable knowledge of the facts, would not discount the value of the interests because of the existence of a discretionary power. In that case, the MIT may be eligible for the roll-over notwithstanding the existence of the power.

1.40 For example, the market value of interests in a MIT might not be significantly affected by the existence of a power that apparently could significantly change the value of the interest, where:

- prudential or market forces effectively prevent the power from being used in a way that would significantly devalue any existing interests;
- the power can only be exercised with the consent of all, or almost all, of the beneficiaries of the trust and there is no particular beneficiary (or group of associated beneficiaries) who control the voting power; and/or

- more generally, there is little or no likelihood that the power will be exercised in a way that significantly reduces the value of each existing interest.

1.41 If the total market value of all of the interests in a MIT is substantially the same as the net value of the trust, this may suggest that the existence of ‘discretionary’ powers in the trust does not significantly affect the market value of interests in the MIT.

### **Example 1.3**

Further to Example 1.2, the trust is a MIT that is listed on the Australian Securities Exchange. There has only ever been one class of units on issue.

Various prudential and regulatory forces prevent the trustee from exercising powers in a way that is detrimental to existing unitholders. Furthermore, the total market value of units in the trust is approximately equal to the net value of the trust.

The trust meets the roll-over condition in section 126-230 because the existence of the power does not significantly affect the market value of interests in the trust.

### Additional requirements for receiving trust

1.42 The receiving trust must have no CGT assets, other than a small amount of cash or debt, just before the transfer time. [*Schedule 1, item 9, paragraph 126-225(1)(b)*]

- If the transfer is part of a series of roll-overs under an arrangement (see paragraphs 1.66 to 1.72), this condition only applies to the *first* transfer time.

1.43 This ‘empty trust’ requirement is important to ensure that the roll-over cannot be used to marry gain and loss assets or else ‘share’ losses in a way that would not otherwise be permitted under the income tax laws.

1.44 If the receiving trust has any revenue or capital losses just after the (first) transfer time, they are effectively extinguished (that is, they cannot be used). This is an automatic consequence of choosing roll-over and is discussed in paragraphs 1.78 to 1.80.

1.45 This approach increases the flexibility of the roll-over by not requiring the receiving trust to be a newly created trust, whilst maintaining the integrity of the tax system.

*The same beneficiaries must have the same interests in both trusts*

1.46 Both trusts must have the same ‘direct’ beneficiaries. In other words, the same entities, acting in the same capacities, must be beneficiaries of both trusts. It is not sufficient that the ‘indirect’ or ultimate beneficiaries of both trusts are the same. *[Schedule 1, item 9, subparagraph 126-225(1)(c)(i)]*

1.47 Further, both trusts must have the same classes of membership interests. *[Schedule 1, item 9, subparagraph 126-225(1)(c)(ii)]*

- Membership interests constitute a class if they have the same, or substantially the same, rights. *[Schedule 1, item 10, subsection 995-1(1)]*

Beneficiaries must have the same interests — the market value test

1.48 The market value test determines whether beneficiaries have the same proportionate membership interests before and after the transfer.

1.49 Under this test, the total market value of each beneficiary’s interests in the transferring trust of a particular class and their interests of the matching class in the receiving trust must be substantially the same just before and just after the transfer time. *[Schedule 1, item 9, subparagraph 126-225(1)(c)(iii)]*

**Example 1.4**

TrustOne is an eligible trust with two beneficiaries: Sheila and Peter. There are two classes of units in the trust:

- Class A units entitle the holder to a share of the rental income from properties held by the trust; and
- Class B units entitle the holder to a share of the capital value of the properties held by the trust.

TrustTwo is also an eligible trust with the same beneficiaries. TrustTwo has two classes of units labelled Class 1 and Class 2, which have the same rights as Classes A and B respectively.

For each beneficiary, the number and market value of units in TrustOne is shown in Table 1.1. Just before the transfer time, the market value of all units in TrustTwo is effectively zero.

**Table 1.1: Number and value of units in TrustOne**

<i>Beneficiary / Unit</i>	<i>Number of units</i>	<i>Market value of each unit</i>	<i>Total market value</i>
<i>Sheila</i>			
Class A units	1,000	\$100	\$100,000
Class B units	1,000	\$1,000	\$1,000,000
<i>Peter</i>			
Class A units	500	\$100	\$50,000
Class B units	Nil	Nil	Nil

The trustee of TrustOne transfers two of its properties to the trustee of TrustTwo for no consideration. As a result, the market values of Class A and Class B units fall and the market values of Class 1 and Class 2 units increase. The trustee of TrustOne incurs fees in the transfer of \$2,000, and is reimbursed from the capital of TrustOne.

**Table 1.2: Market value (MV) of units after the transfer**

<i>Beneficiary / Unit</i>	<i>MV of units in TrustOne</i>	<i>MV of units in TrustTwo</i>	<i>Total market value</i>
<i>Sheila</i>			
Class A / 1	\$80,000	\$20,000	\$100,000
Class B / 2	\$898,000	\$100,000	\$998,000
<i>Peter</i>			
Class A / 1	\$40,000	\$10,000	\$50,000
Class B / 2	Nil	Nil	Nil

Roll-over is available because the total market value of the interests within each pair of the matching classes of units is substantially the same before and after the transfer time.

***Exceptions to roll-over***

1.50 In certain situations, roll-over is not available.

***Foreign trust and not taxable Australian property***

1.51 Roll-over is not available if the receiving trust is a foreign trust for CGT purposes and the transferred asset is not taxable Australian property. Permitting roll-over in these circumstances would effectively allow a CGT exemption for any accrued capital gain, rather than a deferral. [Schedule 1, item 9, subsection 126-235(1)]

*Trusts taxed like companies*

1.52 Roll-over is not available if either trust is a corporate unit trust or a public trading trust at any time in the income year that the transfer occurs. Companies are not eligible to choose this roll-over and, on that basis, trusts that are taxed like companies also cannot choose the roll-over. *[Schedule 1, item 9, subsection 126-235(2)]*

- In order to transfer assets between related companies without immediate CGT consequences, companies are able to form (and head) a consolidated group.

*Trusts have not made the same tax choices*

1.53 Roll-over is not available unless both trusts have the same tax choices (or elections) in force just after the transfer. This applies to any choice made under the tax laws where the *absence* of the same choice in the other trust would or could have an ongoing impact on the calculation of any entity's net income (worked out under sections 90 or 95 of the ITAA 1936) or taxable income. *[Schedule 1, item 9, subsection 126-235(3)]*

1.54 This requirement is important to ensure that trusts cannot use the roll-over to circumvent the conditions in the primary provisions that govern when, why and how the choice can be made, or unmade.

**Example 1.5**

Further to Example 1.4, the trustee of TrustOne has made a family trust election. The individual specified in the election is Sheila.

To be able to choose the roll-over, the trustee of TrustTwo must also make a family trust election with Sheila as the test individual.

1.55 It does not matter whether the *presence* of the original choice in one trust may have an ongoing impact on the calculation of that trust's net income (or any other entity's net income or taxable income). What matters is whether the *absence* of the mirror choice in the 'other trust' has an ongoing impact on any entity's net income or taxable income. *[Schedule 1, item 9, paragraph 126-235(3)(c)]*

**Example 1.6**

Further to Example 1.5, in a previous income year, the trustee of TrustOne chose a CGT roll-over (under Subdivision 124-B) when a property of the trust was destroyed. The trustee of TrustOne purchased a replacement property with an insurance payout.

The trustee of TrustTwo does not need to make a 'mirror choice' of the Subdivision 124-B roll-over. This is because the absence of such a

choice will not affect the calculation of TrustTwo's net income (nor the net income or taxable income of any other entity).

That is, the Subdivision 124-B choice affects the tax position of TrustOne (because it determines the cost base of the replacement asset in the hands of the trustee of TrustOne). The impact of the choice is confined to TrustOne and its absence in TrustTwo has no bearing on TrustTwo's net income (or the net income or taxable income of any other entity).

This will be the case even if the replacement asset is one of the transferred assets in respect of which the trusts now seek to apply the limited fixed trust roll-over.

#### Timing of making a mirror choice

1.56 Generally, mirror choices (if required) must be in force just after the transfer time. However, the roll-over will still be available if:

- the trustee makes the mirror choice before the first time the choice matters for tax purposes; or
- it would not be reasonable to require the making of the mirror choice.

#### *[Schedule 1, item 9, subsection 126-235(4)]*

1.57 The purpose of this reasonableness test is to provide limited flexibility where a trustee cannot make the mirror choice, and the absence of the choice would or could have only an immaterial effect on any entity's net income or taxable income.

#### **Example 1.7**

MarketTrust is a MIT. The trustee of MarketTrust makes the deemed capital account election (proposed but not yet enacted).

In September of the following income year, the trustee of MarketTrust transfers a commercial property to a newly created trust, PropertyTrust. Both trusts are eligible for the roll-over, and have the same beneficiaries with the same proportionate membership interests.

The trustee of PropertyTrust buys and sells 10 commercial properties between September and June.

Before lodging an income tax return for that income year, the trustee of PropertyTrust makes the deemed capital account election.

As the lodgement of the tax return is the first time the election matters for tax purposes, both trusts can choose the roll-over.

However, if the trustee of PropertyTrust did not (or could not) make the capital account election, then roll-over is not available in respect of the property transferred from MarketTrust.

1.58 Where it is necessary for a trustee to make a mirror choice to be able to choose this roll-over, the trustee must still be able to make the choice under the primary provisions that govern when, why and how the choice can be made. Nothing in this roll-over (including the transitional provisions) allows a trustee to make a choice they could not otherwise have made.

1.59 If it is not possible to make the mirror choice, then the roll-over will not be available, unless it would be unreasonable to require that a mirror choice be made (see paragraph 1.56). Denial of the roll-over does not in itself make it unreasonable to require the making of the mirror choice.

#### Consequences of making a mirror choice

1.60 Any restrictions or conditions that apply to the original choice (or first choice) will apply in a corresponding way to the mirror choice. If, just after the transfer time, the trustee that made the first choice cannot revoke or vary that choice, a trustee that makes a mirror choice also cannot revoke or vary that choice. Alternatively, if the first choice can be revoked or varied, but there are tax consequences in doing so, then those consequences will apply if the mirror choice is revoked or varied. *[Schedule 1, item 9, subsection 126-235(5)]*

1.61 This will be the case regardless of whether the circumstances might otherwise have allowed the mirror choice to be revoked or varied; or have allowed it to be revoked or varied without attracting the tax consequences relevant to the first choice.

1.62 The restrictions or conditions to which this rule applies are those that apply to the first choice just after the transfer time. If either choice only becomes irrevocable or unchangeable because of events that occur after the transfer time, this has no effect on the other choice.

1.63 Alternatively, if tax consequences for revoking or varying either choice only arise because of events that occur after the transfer time, this has no effect on the other choice.

1.64 In other words, where the trustee revoking or varying the choice is the trustee that made the first choice, the consequences depend on the history of that trust before and after the transfer time.

1.65 However, where the trustee revoking or varying the choice is the trustee that made the *mirror* choice, the consequences depend on:

- the history of that trust, after the time of the transfer; and
- the history of the other trust, up until the time of the transfer.

### **Example 1.8**

Further to Example 1.5, assume that the trustee of TrustOne cannot revoke the family trust election, because it has previously relied on the family trust election to carry forward and deduct tax losses.

As a result, the trustee of TrustTwo cannot revoke the family trust election, even if it has never used or relied upon the election.

### *Application of the roll-over to multiple assets*

1.66 The roll-over applies on an asset-by-asset basis, which is consistent with the CGT provisions. However, there are special rules to ensure that the roll-over can apply to multiple assets transferred as part of an arrangement.

1.67 If assets were transferred at different times, then in the absence of these special rules, it would be effectively impossible to satisfy the ‘empty trust’ requirement (paragraphs 1.42 to 1.45) at the second and later transfer times. These special rules also avoid any uncertainty that assets transferred simultaneously — say in the sense of being transferred under a single transfer agreement — are, in effect, transferred sequentially and therefore at different times.

1.68 Therefore, the ‘empty trust’ requirement does not apply to the second and later transfer times, provided:

- each asset is transferred from the same transferring trust to the same receiving trust under an arrangement (as defined in subsection 995-1(1));
- the asset was an asset of the transferring trust at the start of the arrangement; and
- the asset is transferred in the same income year of the transferring trust as the first transfer time.

*[Schedule 1, item 9, subsection 126-225(2)]*

1.69 If these conditions are met, the loss cancellation rules do not apply to the second and later transfer times (see paragraphs 1.78 to 1.80). *[Schedule 1, item 9, subsection 126-240(3)]*

1.70 The requirement that CGT event E4 must be capable of happening to all the membership interests of both trusts and that beneficiaries' entitlements cannot be discretionary must be met at all times during the period of the arrangement — that is, at all times from the first asset transfer to the last asset transfer. *[Schedule 1, item 9, subsection 126-230(1)]*

1.71 However, the requirements that each trust has the same beneficiaries with the same proportional interests need only be met at the transfer time of each asset under the arrangement. The exceptions also apply at each transfer time.

1.72 If the roll-over does not apply to one or more assets transferred under an arrangement, this does not invalidate previous successful roll-overs. It also does not necessarily prevent the roll-over from applying to future transfers under the arrangement, provided the conditions of the roll-over are satisfied at that time.

### **Example 1.9**

Further to Example 1.4, assume that the trustees of TrustOne and TrustTwo made an arrangement to transfer a total of five properties. All of the properties were assets of TrustOne at the time. All of the events in this example occurred during the same income year in which the arrangement was made.

Two properties were rolled over at the first transfer time. The receiving trust satisfied the 'empty trust' requirement at that time.

The trustee of TrustOne transfers another property to TrustTwo. Although TrustTwo has significant CGT assets (two properties), the trustees can still choose the roll-over if all of the other conditions are met. (The losses of TrustTwo are not extinguished — see paragraph 1.80.)

Before the transfer of the fourth property, Peter sells his interest in TrustOne to Graeme. When the property is transferred, roll-over is not available because the beneficiaries of both trusts are not the same.

Peter sells his interest in TrustTwo to Graeme before the transfer of the fifth property. As the beneficiaries of both trusts are the same, the roll-over may be chosen for the fifth property if all the conditions (other than the 'empty trust' requirement) are met.

Suppose that the trustee of TrustOne sold one of the original five properties and purchased a replacement property. The roll-over cannot be chosen for that replacement property because it was not an asset of TrustOne when the arrangement was made.

***Consequences of roll-over for the trustees***

1.73 There are consequences for the trustee of the transferring trust (in respect of any capital gain or capital loss arising from the asset transfer). There are also consequences for the trustee of the receiving trust (in respect of tax attributes relevant to the transferred asset in its hands).

***Capital gain or capital loss disregarded***

1.74 If both trustees choose the roll-over, any capital gain or capital loss made by the trustee of the transferring trust in respect of the transferred asset is disregarded. [*Schedule 1, item 9, subsection 126-240(1)*]

***Asset's cost base and reduced cost base***

1.75 The first element of the cost base and reduced cost base of the asset in the hands of the trustee of the receiving trust is equal to the cost base and reduced cost base of the asset in the hands of the trustee of the transferring trust just before the transfer time. [*Schedule 1, item 9, subsection 126-240(2)*]

***Asset's date of acquisition***

1.76 If the trustee of the transferring trust acquired the asset before 20 September 1985, the trustee of the receiving trust is taken to have acquired the asset before that date. [*Schedule 1, item 9, subsection 126-240(4)*]

1.77 Otherwise, the general acquisition rules in Subdivision 109-A apply — that is, the receiving trust acquires the roll-over asset when the trust is created or the asset is transferred. However, for the purposes of the CGT discount, the ownership period of the transferred asset in the receiving trust includes the period of ownership by the trustee of the transferring trust (see paragraph 1.111).

**Example 1.10**

To return to Example 1.2, the trustees of both trusts choose the roll-over. The two properties transferred were called Beachside (acquired in 1991) and Bayside (acquired before 20 September 1985). The cost base and reduced cost base of Beachside in the hands of the trustee of TrustOne was \$20,000.

The trustee of TrustOne disregards any capital gain or capital loss made on the transfer of Beachside and Bayside to the trustee of TrustTwo.

The first element of the cost base and reduced cost base of Beachside in the hands of the trustee of TrustTwo is \$20,000. The trustee of TrustTwo is also taken to have acquired Bayside before 20 September 1985.

#### *Losses extinguished*

1.78 If the receiving trust has carried forward any net capital losses or tax losses made in an income year that ends before the transfer time, they cannot be used to reduce the trust's capital gains or its assessable income after the transfer. The losses are effectively extinguished. [*Schedule 1, item 9, subsection 126-240(3)*]

- This ensures the roll-over cannot be used to marry gains and losses. For example, it cannot be used to transfer gain assets under cover of the roll-over to a trust with capital or revenue losses.

1.79 For the income year that includes the transfer time, the trustee of the receiving trust makes a notional calculation as to whether it would have had a net capital loss or a tax loss if the income year had ended just before the transfer time.

- If there would have been a net capital loss, that amount is effectively extinguished by reducing the sum of capital losses at the end of the year by that amount (whether or not the trust is otherwise in a net capital gain or capital loss position).
- If there would have been a tax loss, that amount is effectively extinguished by reducing the sum of deductions at the end of the year by that amount (whether or not the trust is otherwise in a taxable income or a tax loss position).

1.80 As noted earlier, if multiple assets are rolled over as part of an arrangement, the extinguishment of losses only applies at the first transfer time. [*Schedule 1, item 9, subsection 126-240(3)*]

#### *Consequences of the roll-over for depreciating assets*

1.81 The transfer of a depreciating asset from the transferring trust to the receiving trust will cause a balancing adjustment event (as defined by section 40-295).

1.82 Where there is a difference between the asset's termination value (the final sale price) and its adjustable value (the original cost less the decline in value while the taxpayer held it), a balancing adjustment may occur.

1.83 The trustee of the transferring trust will be eligible for roll-over under section 40-340 if three conditions are satisfied:

- there is a balancing adjustment event caused by the disposal of a depreciating asset;
- the disposal involves a CGT event; and
- the limited fixed trust CGT roll-over is chosen.

*[Schedule 1, item 4, subsection 40-340(1)]*

1.84 As a result of the roll-over, the consequences of the balancing adjustment are deferred until a subsequent balancing adjustment event. The trustee of the receiving trust can continue to claim deductions for the depreciating asset in the same way as the trustee of the transferring trust could.

### ***Consequences for beneficiaries***

1.85 Beneficiaries are required to adjust the cost base and reduced cost base of their interests in both trusts.

- Although there is no disposal of membership interests in the transferring trust, there may be a transfer of value from interests in the transferring trust to interests in the receiving trust.
- Consistent with the approach for other CGT roll-overs and the 'empty trust' requirement, the acquisition date of beneficiaries' interests in the receiving trust will also change.

1.86 Cost base adjustments are done on an interest-by-interest basis. However, because adjustments are made on a reasonable basis, there may be an opportunity for beneficiaries to reduce their compliance costs by grouping relevant membership interests (for example, where they have common tax attributes). This is explained further in Example 1.11.

1.87 The general rule is that beneficiaries must make these adjustments in respect of each asset transfer (paragraphs 1.88 to 1.94). Alternatively, beneficiaries may be permitted to make a single adjustment covering multiple asset transfers (paragraphs 1.98 to 1.100). *[Schedule 1, item 9, subsection 126-245(1)]*

*Adjusting cost bases and reduced cost bases*

1.88 The first element of the cost base and reduced cost base of each membership interest in the transferring trust after the transfer time is a proportion of the cost base of that interest, just before the transfer time. *[Schedule 1, item 9, subsections 126-245(2) and (4)]*

- The proportion is what is reasonable having regard to the market value of that interest (or a reasonable approximation of its market value), just before and just after the transfer time.
- The effect of the adjustment is to reduce the other elements of the cost base and reduced cost base to zero. This ensures that elements of the cost base are not double-counted in this roll-over.

1.89 The following formula is a reasonable basis for calculating the first element of the cost base of each interest in the transferring trust:

$$\text{Cost base (pre-transfer)} \times \frac{\text{Market Value (post-transfer)}}{\text{Market Value (pre-transfer)}}$$

1.90 The first element of the cost base and reduced cost base of each membership interest in the receiving trust is an amount such that the total cost base of that interest and the cost base of the corresponding interest(s) or proportion of interest in the transferring trust, just after the transfer time, reasonably approximates the total cost base of those interests just before the transfer time. *[Schedule 1, item 9, subsections 126-245(3) and (4)]*

- In other words, the increase in cost bases of interests in the receiving trust matches the decrease in cost bases of corresponding interests in the transferring trust.

1.91 The following formula can be used to calculate a reasonable approximation of the first element of the cost base of each interest in the receiving trust (which is in bold):

$$\mathbf{CB}_{\text{1st element}}^{\text{Receiving}} + \mathbf{CB}_{\text{1st element}}^{\text{Transferring}}(\text{after}) = \mathbf{CB}^{\text{Receiving}} + \mathbf{CB}^{\text{Transferring}}(\text{before})$$

where CB is the cost base; the interest(s) or proportion of interest in the transferring trust corresponds to the interest in the receiving trust; and, the time is just before and just after the transfer time.

1.92 One interest of a particular class in the receiving trust may correspond to more than, less than or exactly one interest of the matching class in the transferring trust.

- For example, a beneficiary may have two Class A units in the receiving trust for each Class A interest in the transferring trust, as well as one Class B unit in the receiving trust for every five Class B units in the transferring trust.
- However, the proportion of interests of a particular class that a beneficiary has in the receiving trust (for example, 10 per cent of all the Class A units on issue) will be the same proportion of the matching class of units in the transferring trust held by that beneficiary.

1.93 The trustee of the transferring trust must provide beneficiaries with sufficient information to make these calculations (see paragraphs 1.101 to 1.105).

1.94 If a beneficiary adjusts the cost base and reduced cost base of their interests in both trusts as a result of the roll-over, no other adjustments can be made under the ITAA 1997 or the ITAA 1936 because of something that happens in relation to the asset transfer from the transferring trust to the receiving trust. [*Schedule 1, item 9, section 126-255*]

**Example 1.11**

Further to Example 1.9, assume that Sheila’s Class A units in TrustOne have different cost bases as a result of her purchasing them at two different prices. The cost bases of these units and the corresponding units in TrustTwo are shown in Table 1.3.

**Table 1.3: Corresponding units for each original unit**

<i>Original units</i>	<i>Cost base</i>	<i>New units</i>	<i>Cost base</i>
600 Class A units	\$10 each	300 Class 1 units	\$0
400 Class A units	\$20 each	200 Class 1 units	\$0
1,000 Class B units	\$200 each	100 Class 2 units	\$10 each

Sheila adjusts the cost base of her units in the transferring trust on a reasonable basis, having regard to the market value of the interests just before and just after the transfer time. Given the difference in cost base of the two groups of Class A units, it would not be reasonable for Sheila to adjust the units as a single group.

The market value of Class A units just before the transfer was \$100 and just after the transfer was \$80 (see Tables 1.1 and 1.2). The

market value of Class B units before the transfer was \$1,000 and after the transfer was \$898. These are relevant in determining the first element of the cost base of each unit in the TrustOne (the first three rows of Table 1.4).

For example, the cost base of each of the 600 Class A units just before the transfer was \$10. A reasonable proportion of that cost base is the market value after the transfer (\$80) divided by the market value before the transfer (\$100). Multiplying \$10 by ( $\$80 / \$100$ ) equals \$8, the first element of the cost base of those interests after the transfer.

Using these cost bases, Sheila calculates the first element of the cost base of interests in TrustTwo, such that the sum of the cost bases of corresponding units in both trusts is the same before and after the transfer time (the last three rows of Table 1.4).

For example, just before the transfer, the total cost base of one Class 1 unit and the corresponding two Class A units was \$20 ( $2 \times \$10 + 0$ ). Just after the transfer, the cost base of the two Class A units is \$16 ( $2 \times \$8$ ). Therefore, the first element of the cost base of the Class 1 unit is \$4 using the formula in paragraph 1.91.

**Table 1.4: Calculating the cost base of each unit**

<i>Membership interest</i>	<i>Cost base</i>
600 Class A units	<b>\$8</b> — $\$10 \times (80 / 100)$
400 Class A units	<b>\$16</b> — $\$20 \times (80 / 100)$
1,000 Class B units	<b>\$180</b> — $\$200 \times (898 / 1,000)$ (approx)
300 Class 1 units	<b>\$4</b> — $\$4 + (2 \times \$8) = \$0 + (2 \times \$10)$
200 Class 1 units	<b>\$8</b> — $\$8 + (2 \times \$16) = \$0 + (2 \times \$20)$
100 Class 2 units	<b>\$210</b> — $\$210 + (10 \times \$180) = \$10 + (10 \times \$200)$

Assume that each unit had the same cost base and reduced cost base before the transfer. Therefore, the amount worked out above as the first element of the cost base of each unit will also become the first element of the reduced cost base of each unit.

*Deemed acquisition date of interests in receiving trust*

1.95 Beneficiaries are deemed to have acquired their interests in the receiving trust at the transfer time. This is consistent with the general approach for CGT roll-overs. It is also consistent with the ‘empty trust’ approach. Furthermore, it prevents the potential avoidance of tax, such as by receiving trusts with pre-CGT interests being loaded with post-CGT assets and the beneficiaries disposing of their pre-CGT interests (instead of the receiving trust disposing of its post-CGT assets). [*Schedule 1, item 9, subsection 126-245(5)*]

1.96 There is one exception. Interests in the receiving trust will be taken to have been acquired before 20 September 1985 if corresponding interests in the transferring trust were acquired before that date.

[Schedule 1, item 9, subsection 126-245(6)]

1.97 For the purposes of the CGT discount, the ownership period of membership interests in the receiving trust includes the period of ownership of membership interests in the transferring trust (see paragraph 1.112)

### Example 1.12

Further to Example 1.11, suppose that Sheila also has 1,000 Class A units that she acquired before 20 September 1985. She still has only 500 Class 1 units in the receiving trust. Taking this into account, the new allocation of units in TrustTwo is shown in Table 1.5.

**Table 1.5: Corresponding units for each original parcel**

<i>Original units</i>	<i>Cost base</i>	<i>Corresponding units</i>	<i>Cost base</i>
600 Class A units	\$10 each	150 Class 1 units	\$0
400 Class A units	\$20 each	100 Class 1 units	\$0
1,000 Class A units	Nil	250 Class 1 units	\$0

Because half of Sheila's Class A units in TrustOne were acquired before 20 September 1985, she is deemed to have acquired half (250) of the corresponding Class 1 units in TrustTwo before that date.

The cost bases of the Class A units (before and after the adjustment) do not change from Example 1.11. However, a reasonable calculation of the cost base of each of the Class 1 units taken to have been acquired at the transfer time does change, because now one Class 1 unit in TrustTwo corresponds to four Class A units in TrustOne instead of two.

For example, just before the transfer, the total cost base of one Class 1 unit and the corresponding *four* Class A units was \$40 ( $4 \times \$10 + 0$ ). Just after the transfer, the cost base of the *four* Class A units is \$32 ( $4 \times \$8$ ). Therefore, the first element of the cost base of the Class 1 unit is \$8.

Similarly, the first element of the cost base of the other 100 Class 1 units is \$16. Using the formula explained in paragraph 1.91, the calculation is as follows:  $\$16 + (4 \times \$16) = \$0 + (4 \times \$20)$ .

*Other approach for making adjustments covering multiple transfers*

1.98 If there is a series of roll-overs for assets transferred under an arrangement and a beneficiary continuously owns interests in the transferring trust over a period of time that covers multiple transfers, the beneficiary can choose to make the necessary cost base and acquisition date adjustments only once for those interests. [*Schedule 1, item 9, section 126-250*]

1.99 A beneficiary that chooses this approach adjusts the cost bases of interests in the transferring trust based on the market value (or a reasonable approximation of market value) of those interests just before the *first* transfer, and just after the *last* transfer.

- Similarly, the beneficiary adjusts the cost bases of the corresponding interests in the receiving trust such that the total cost base of the corresponding interests in both trusts, just after the *last* transfer, reasonably approximates the total cost base just before the *first* transfer.
- The acquisition date of those interests in the receiving trust is treated as having been acquired just after the transfer time of the *last* transfer in the chosen series.
- Note that whilst the condition for applying this approach is couched in terms of continuing ownership of interests in the transferring trust, the beneficiary must also continuously own corresponding interests in the receiving trust for the roll-over to apply.

[*Schedule 1, item 9, subsection 126-250(3)*]

1.100 If a beneficiary disposes of their interests in either trust part way through an arrangement, they must adjust the cost bases and relevant acquisition dates of those interests based on the most recent transfer time before the disposal. This is because the beneficiary will not be able to choose the multiple-transfer approach for a subsequent roll-over in respect of those interests, or the corresponding interests in the ‘other trust’.

**Example 1.13**

To return to Example 1.9, because Sheila continuously held her interests in both trusts throughout the period, she could choose to adjust the cost base and reduced cost base of her interests based on the market value of her interests just before the first transfer, and just after the transfer of the fifth property.

Because Peter sold his interest in the transferring trust after the second transfer time, he must adjust the cost base and reduced cost base of the interest based on the market value of the interest just after the second transfer time. He also adjusts the cost base, reduced cost base and acquisition date of his corresponding interest in the receiving trust. (Alternatively, Peter can choose to make the necessary adjustments at the first and second transfer time using the transfer-by-transfer approach.)

As Graeme is only involved in one successful roll-over, he adjusts the cost bases and acquisition dates of his interests using the transfer-by-transfer approach.

***Trustee must give relevant information to beneficiaries***

1.101 The trustee of the transferring trust must send written notice containing certain information to each of its beneficiaries (as at the transfer time) within three months of the end of the income year in which the transfer occurs. [*Schedule 1, item 9, subsection 126-260(1)*]

- The trustee may send the notice by post to the beneficiary's most recently notified address, or by any other means chosen by the beneficiary for receiving correspondence.
- Beneficiaries need this information to be able to comply with their obligations under the income tax laws — for example, to determine the consequences of the roll-over for their membership interests in the transferring and receiving trusts.

1.102 The following information must be included in the notice given to each beneficiary (other information may also be included):

- the transfer time;
- the market value of each of the beneficiary's membership interests in the transferring trust, both just before and just after the transfer time; and
- sufficient information to allow beneficiaries to work out which interests in the receiving trust correspond to each of the beneficiary's interests in the transferring trust. This effectively requires the beneficiary to know:
  - the class of interests in the receiving trust that matches each class of interests in the transferring trust; and

- for each matching class, the number of interests in the receiving trust that equals one matching interest in the transferring trust.

*[Schedule 1, item 9, subsection 126-260(2)]*

1.103 Failure to comply with this requirement is a strict liability offence, punishable by 30 penalty units. The purpose of this offence is to place trustees on notice against contravening the requirement to give beneficiaries the information they need to meet their obligations.

*[Schedule 1, item 9, subsections 126-260(3) and (4)]*

1.104 If there are two or more trustees, each trustee is liable, although any trustee can discharge the obligation for all of the trustees. *[Schedule 1, item 9, subsection 126-260(5)]*

1.105 However, it is a defence if the trustee being prosecuted proves that the trustee did not in any way contribute to the failure to provide the necessary information to beneficiaries, by act or omission. The reversal of the burden of proof is necessary given that the offence is one of strict liability, and that beneficiaries need the information to meet their obligations. *[Schedule 1, item 9, subsection 126-260(6)]*

*Roll-over consequences still apply for beneficiary if no notice given*

1.106 The consequences for beneficiaries explained in paragraphs 1.85 to 1.100 still apply even if the trustee of the transferring trust fails to comply with the requirement to give notice. That is, the obligation on the trustee of the transferring trust does not relieve a beneficiary of its obligation to make cost base and other adjustments in respect of its membership interests. *[Schedule 1, item 9, subsection 126-260(7)]*

## **Application and transitional provisions**

1.107 These amendments will apply to CGT events happening on or after 1 November 2008. *[Schedule 1, items 3 and 11]*

## **Additional time for trustees making tax choices**

1.108 Trustees will have six months from the date of Royal Assent to make the mirror tax choices discussed in paragraph 1.53, notwithstanding that the absence of the election impacted on the assessment of the trust's or any other entity's income.

- However, a mirror choice may only be made under this transitional rule if it otherwise meets the requirements of the

relevant choice provision and is within the time permitted by that provision.

- The Commissioner of Taxation can extend the six-month period.

*[Schedule 1, item 12]*

### **Transitional time for penalty provision**

1.109 To avoid any retrospective penalties from the failure of a trustee to provide beneficiaries with relevant information for a roll-over that occurs in the 2008-09 income year, the trustee will have six months from the date of Royal Assent to comply with the requirement to give information. *[Schedule 1, item 13]*

### **Consequential amendments**

1.110 Consequential amendments will be made to the guide material in Subdivision 112-B to direct readers to the modified cost base rules in Subdivision 126-G. Subdivision 112-B lists situations when the general cost base and reduced cost base rules may be modified. *[Schedule 1, item 6, section 112-54A]*

1.111 Consequential amendments will also be made to include the roll-over of the asset at the trust level in the table of same-asset roll-overs in Subdivision 112-D. This will ensure that, for the purposes of the CGT discount, the ownership period of the roll-over asset in the hands of the trustee of the receiving trust includes the period of ownership by the trustee of the transferring trust. *[Schedule 1, item 7, section 112-150]*

1.112 Consequential amendments will also be made to the table in subsection 115-30(1). This will ensure that, for the purposes of the CGT discount, the ownership period of membership interests in the receiving trust includes the period of ownership of the corresponding membership interests in the transferring trust. *[Schedule 1, item 8, subsection 115-30(1)]*

1.113 Amendments will be made to the guide material in Subdivision 109-B to direct readers to this modified acquisition rule in section 115-30. *[Schedule 1, item 5, section 109-55]*

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## **Chapter 2**

# ***Loss relief for merging superannuation funds***

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### **Outline of chapter**

2.1 Schedule 2 to this Bill removes significant income tax impediments to mergers between complying superannuation funds by permitting the roll-over of capital losses and transfer of revenue losses (including losses realised under the merger and previously realised losses). This loss relief will be available for complying superannuation funds and approved deposit funds (ADFs) that merge with a complying superannuation fund with five or more members. The loss transfer and asset roll-over will preserve the offsetting value of the losses, thereby removing a potential barrier to superannuation fund consolidation.

### **Context of amendments**

2.2 Capital gains tax (CGT) is the primary code for calculating gains or losses of complying superannuation funds. There are certain gains and losses that are treated on revenue account, such as those from a debenture stock or bond (see section 295-85 of the *Income Tax Assessment Act 1997* (ITAA 1997)).

2.3 The transfer of assets from one superannuation fund to another, under a merger between the two funds, will typically trigger CGT event A1 (about disposals of a CGT asset — section 104-10 of the ITAA 1997) or may trigger CGT event E2 (about transferring a CGT asset to a trust — section 104-60 of the ITAA 1997). Therefore, the asset transfer will lead to the realisation of capital gains and/or capital losses for the transferring fund. Following this asset transfer and the transfer of members' accounts to the receiving fund, the transferring fund will typically be wound up.

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

2.5 Similarly, revenue losses, such as foreign exchange losses, are also extinguished on the ending of an entity. Revenue losses also have a value as they can be offset against current year income, or carried forward where the entity continues to exist. However, where there is a merger and the transferring entity ceases to exist, the value of the revenue losses is also extinguished.

2.6 In the absence of the optional loss relief provided by the amendments, where the tax benefits of unrealised net capital losses or revenue losses have been included in the valuation of members' superannuation interests, then the merger of their superannuation fund with another fund will lead to a reduction in the value of their superannuation interests. This can act as an obstacle to the superannuation fund merging with another fund because the trustee has to take this reduction into account when considering such a merger. The trustee may decide to abandon any merger plans where there is a significant negative impact on members' benefits. The optional loss relief provided by the amendments removes the impediment to eligible funds merging that the extinguishment of the losses would otherwise impose.

2.7 This loss relief encompasses transfers to and from pooled superannuation trusts (PSTs) and life insurance companies as well as superannuation funds and ADFs. Providing the loss relief to superannuation fund mergers involving these kinds of entities recognises the commercial reality that a significant amount of superannuation is invested via PSTs and life insurance companies rather than being directly invested by the superannuation fund.

2.8 In light of the uncertain conditions in the global economy and recent global financial market turmoil, it is important that potential barriers to a robust and efficient superannuation industry are minimised. This measure will enhance the efficiency and robustness of the superannuation system in response to these uncertainties.

2.9 Capital gains do not have the same disincentive impact on mergers of superannuation funds as capital losses. Superannuation funds typically include the tax cost of any unrealised capital gains when they calculate the value of their members' interests. The tax cost of the realisation of the unrealised capital gains has already been proportionally included in that value. This means that when the merger takes place, the CGT that is paid on the net capital gain of the merging fund does not lead to a reduction in member benefits.

## Summary of new law

2.10 Schedule 2 amends the ITAA 1997 by inserting Division 310. This Division allows a complying superannuation fund or a complying ADF to choose to roll-over capital losses and revenue losses arising from an arrangement to merge the fund with a complying superannuation fund with five or more members. This is achieved through the provision of a loss transfer and an asset roll-over. The transferring fund may also transfer previously realised capital losses and revenue losses, including its prior year losses.

2.11 The Division allows for two options for the asset roll-over depending on the net capital gain or loss position of the entity in relation to the transferred assets. If an entity is in a net capital loss position in relation to the transferred assets for the current year, it may choose either the global asset approach or the individual asset approach. If the entity is not in that position, it can only choose the individual asset approach.

2.12 Subdivision 310-B sets out what entities are eligible for the loss relief and Subdivisions 310-C to 310-E set out the consequences of choosing the loss transfer or asset roll-over for these entities.

## Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
Previously realised capital losses and revenue losses may be transferred under a merger of complying superannuation funds where certain eligibility conditions are met.	Previously realised capital losses and revenue losses cannot be transferred under a merger of complying superannuation funds.
Capital losses and revenue losses realised under an arrangement to merge a complying superannuation fund or a complying ADF with a complying superannuation fund with five or more members may be rolled over under the merger.	Capital losses and revenue losses realised from a merger of superannuation funds cannot be transferred and are lost when the transferring superannuation fund is wound up.

## **Detailed explanation of new law**

### **When an entity may choose the loss transfer and asset roll-over**

2.13 New provisions are inserted into the ITAA 1997 to specify the conditions necessary for the trustees of certain entities to be eligible to choose the optional loss transfer and asset roll-over when there is an arrangement to merge complying superannuation funds. The broad term ‘arrangement’ is used in these provisions as it is not intended to limit the manner in which superannuation entities may merge. [*Schedule 2, Part 1, item 1, Division 310*]

2.14 The satisfaction by the transferring superannuation fund of the eligibility rules for the loss relief does not of itself authorise the particular merger or transfer transaction. The trustees of the relevant funds would need to consider the applicable governing trust deeds and legislation. This may include relevant prudential regulatory requirements for the proposed transaction. For example, the requirements of the *Superannuation Industry (Supervision) Act 1993* (SIS Act 1993) and the *Superannuation Industry (Supervision) Regulations 1994* (SIS Reg 1994), such as the rules protecting member entitlements in the continuing superannuation entity, may need to be considered.

2.15 The measure does not impose any additional record-keeping requirements on the parties to the merger arrangement. However, the ordinary record-keeping provisions of the income tax law will apply to these arrangements. The parties to the merger arrangement should prepare sufficient documentation to satisfy the applicable income tax requirements.

2.16 An eligible entity with an arrangement to merge superannuation funds may choose:

- a loss transfer only;
- an asset roll-over only; or
- a combination of the loss transfer and the asset roll-over,

where the relevant conditions are satisfied. [*Schedule 2, Part 1, item 1, subsections 310-10(1), 310-15(1), 310-20(1) and 310-45(1)*]

2.17 Eligibility for the asset roll-over is conditional on an entity being eligible for the loss transfer, but will not be dependent on the entity actually choosing the loss transfer. This will permit an arrangement to merge superannuation funds to occur in the following ways:

- the transfer of cash only following the disposal of all the transferring entity's assets;
- the transfer of assets only; or
- a combination of cash and asset transfers.

*[Schedule 2, Part 1, item 1, paragraph 310-45(1)(a)]*

2.18 The detail of the asset roll-over mechanism is explained in paragraphs 2.58 to 2.105. Rules to specify the consequences for the various types of losses and assets for each entity that is a party to an arrangement to merge superannuation funds are described in paragraphs 2.45 to 2.57 and paragraphs 2.84 to 2.107.

2.19 The conditions that must exist for an entity to choose the loss transfer and the asset roll-over in respect of an arrangement to merge superannuation funds are specified separately for the different ways in which a complying superannuation fund or ADF may hold assets. Assets may be held directly, through a PST or through a policy with a life insurance company. *[Schedule 2, Part 1, item 1, sections 310-10, 310-15, 310-20 and 310-45]*

***Original fund's assets extend beyond life insurance policies and units in pooled superannuation trusts***

*The first condition — assets held by a fund*

2.20 The first condition for the loss transfer is that the assets must be held by a complying superannuation fund or a complying ADF (the transferring fund) just before the arrangement to merge was made.

- A 'complying superannuation fund' is defined in section 41 of the SIS Act 1993.
- An 'ADF' is defined in section 10 of the SIS Act 1993.

*[Schedule 2, Part 1, item 1, subsections 310-10(1) and (2)]*

2.21 Although the transferring fund is required to have held the assets just before the arrangement was made, it is not required to transfer these assets to the continuing fund in order to access the loss transfer. This allows for the possibility of an arrangement under which the transferring

fund, for example, liquidates its assets and then transfers cash and realised losses to the continuing fund. [*Schedule 2, Part 1, item 1, subsection 310-10(2) and section 310-30*]

*The second condition — fund ceases to have members*

2.22 The second condition for the loss transfer is that the transferring fund ceases to have any members and the individuals who cease to be members become members of one or more complying superannuation funds(s) (the continuing fund(s)). The time that this occurs is the completion time for the merger arrangement for the purposes of the loss relief. [*Schedule 2, Part 1, item 1, subsection 310-10(3)*]

2.23 This condition ensures that the loss relief is only available in circumstances where funds are merging with each other for the purpose of superannuation industry consolidation. Where the transfer of members under an arrangement to merge funds that meets the conditions for the loss relief takes place in more than one transaction, the loss relief will be available. However, the loss transfer is not available for routine transfers of members between funds where the transferring fund continues to have members (apart from members who cannot be transferred due to a legal impediment as discussed below).

2.24 There is a limited exception to the requirement that the transferring superannuation fund must have no members at the completion of the transfer of assets. This exception recognises that there may be circumstances beyond the control of the trustee of a superannuation fund that will not allow the trustee to transfer some of the fund's members to the continuing fund. [*Schedule 2, Part 1, item 1, subsection 310-10(5)*]

2.25 These circumstances may include:

- Family Court orders;
- an unsettled insurance claim for death or disability with the transferring fund; or
- extant legal proceedings that relate to a member of the transferring fund which mean that the member retains rights against the trustee of the transferring fund.

2.26 This exception allows funds that merge to obtain the loss relief even though they cannot fully satisfy the requirement that all members be transferred to the continuing entity due to legal impediments beyond the control of the trustee. [*Schedule 2, Part 1, item 1, subsection 310-10(5)*]

### **Example 2.1**

Warm Super is a complying superannuation fund with 150 members. The trustee of Warm Super decides to merge with and transfer its members to Hot Super, a complying superannuation fund with 1,000 members. Hot Super holds units in the Jalapeno PST.

Under the merger, Warm Super disposes of all its assets and gives the proceeds to Hot Super which uses the proceeds to purchase additional units in the Jalapeno PST. Warm Super would qualify for the loss transfer if it ceases to hold all its assets and ceases to have any members just after the transfer.

### **Example 2.2**

Silver Super is a complying superannuation fund with 12,000 members. Its trustee decides on a merger with Gold Super, a complying superannuation fund with 200,000 members.

Silver Super transfers its assets, losses and members to Gold Super. However, Silver Super has a member who cannot be transferred to Gold Super because the trustee of Silver Super has an unresolved insurance claim for disability in relation to that member. As this insurance claim is a circumstance beyond the control of the trustee of Silver Super, this member is exempt from the requirement that Silver Super transfer all its members to Gold Super.

#### *The third condition — number of members of the continuing entity*

2.27 The third condition of the loss transfer concerns the minimum number of members that the continuing fund or funds must have just before the arrangement to merge the funds was made.

2.28 The general principle is that the continuing fund must not be a small superannuation fund. A **small superannuation fund** is defined in subsection 995-1(1) of the ITAA 1997 as being a complying superannuation fund with four or fewer members.

2.29 Small superannuation funds include self-managed superannuation funds (SMSFs) and small Australian Prudential Regulation Authority (APRA) regulated funds. Small APRA regulated superannuation funds are APRA regulated superannuation funds with less than five members that are managed by an independent trustee. Consequently, a large (non-small) complying superannuation fund is a complying superannuation fund with at least five members.

2.30 Consistent with the objective of removing impediments to the consolidation of the superannuation industry, the continuing fund must not be a small fund. [*Schedule 2, Part 1, item 1, paragraph 310-10(4)(a)*]

2.31 The loss relief may be available in circumstances where a SMSF merges with a non-small APRA regulated superannuation fund. However, it will not be available where the two funds are SMSFs before the merger or where a SMSF merges with a small APRA regulated fund. The continuing superannuation fund must be a complying large APRA regulated fund immediately before the transfer of assets. [*Schedule 2, Part 1, item 1, paragraph 310-10(4)(a)*]

### **Example 2.3**

Miser Trust and Prudent Trust are two SMSFs. Miser has two members and Prudent has four members. The trustees of the two funds wish to merge the two funds with one another. As neither of the funds is a complying superannuation entity with at least five members before the arrangement is made, the merger arrangement will not satisfy all the conditions for the loss relief and therefore will not be eligible for the relief.

2.32 However, there is a limited exception to these general rules. A rule is inserted to ensure that the loss transfer is available in circumstances where two or more superannuation funds merge under an arrangement whereby a new superannuation fund is created. In these cases it will be necessary for at least one of the funds that is merging into the new entity to not be a small superannuation fund just before the arrangement was made. It will also be necessary for the continuing entity to not be a small superannuation fund just after the earliest time when both the other fund and the transferring fund cease to have any members. [*Schedule 2, Part 1, item 1, paragraph 310-10(4)(b)*]

### ***Original fund's assets include a life insurance policy***

2.33 An eligible complying superannuation fund or ADF may hold assets via a complying superannuation/first home saver account (FHSA) life insurance policy. The transferring superannuation fund may, as part of its merger with the continuing fund, transfer its policy to the continuing fund or request the insurance company to transfer the value of the assets that supported its policy to the continuing fund, PST or another life insurance company.

2.34 The life insurance company may be able to use the loss transfer upon cancellation of the life insurance policy, in relation to those of its assets reasonably attributable to and reflected in the value of the policy. Given the type of life insurance policy to which this aspect of the relief applies, the policy would be supported by assets in the complying superannuation/FHSA asset pool of the life insurance company, in terms of the life insurance company taxation rules in Division 320 of the ITAA 1997. The complying superannuation/FHSA asset pool comprises the assets of a life insurance company that are segregated from other

assets for the purpose of discharging its complying superannuation/FHSA liabilities. The loss relief will preserve the value of losses associated with assets having the necessary relationship with the policy held by the superannuation fund.

2.35 Where the asset is a life insurance policy, it is the life insurance company that may choose the loss transfer. *[Schedule 2, Part 1, item 1, subsection 310-15(1)]*

2.36 Provisions are inserted to specify relevantly the same conditions and exceptions for the loss transfer where assets are held in a life insurance company as the conditions and exceptions for assets other than life insurance policies or units in a PST held by a complying superannuation fund or ADF. *[Schedule 2, Part 1, item 1, subsections 310-15(2) to (5)]*

2.37 Where appropriate the conditions are modified to reflect that the superannuation fund holds assets via a complying superannuation/FHSA life insurance policy. For example, the first condition for the life insurance company to be eligible to choose the loss transfer is framed from the perspective of the life insurance company and a life insurance policy to reflect the characteristics of this form of holding superannuation fund assets. *[Schedule 2, Part 1, item 1, subsection 310-15(2)]*

#### **Example 2.4**

JOH Ltd is the trustee of Yellow Super, a complying superannuation fund. The trustee invests in a complying superannuation/FHSA life insurance policy with Bountiful Life. JOH Ltd transfers all the members of Yellow Super to Mauve Super, another complying superannuation fund.

The trustee of Mauve Super does not intend to have a policy with Bountiful Life. However, as part of the transfer Mauve Super has agreed to accept losses and assets of Bountiful Life which were attributable to the policy with Yellow Super.

If Yellow Super, Mauve Super and Bountiful Life satisfy the requirements of the loss transfer, Bountiful Life will be able to obtain the loss transfer and transfer capital losses and revenue losses having the necessary relationship with the Yellow Super policy to Mauve Super.

2.38 The cancellation, novation or transfer of the relevant life insurance policy to the continuing superannuation fund may receive CGT relief for the transferring superannuation fund through the operation of section 118-300 of the ITAA 1997, which disregards certain capital gains or capital losses that arise from CGT events happening in relation to interests in life insurance policies.

***Original fund's assets include units in a pooled superannuation trust***

2.39 Where assets of an eligible superannuation fund or ADF are held via units in a PST, the trustee of the PST will be able to qualify for the loss relief. PSTs may be used by superannuation funds to indirectly hold the investment assets from which their members derive benefits. This permits the superannuation funds to allocate the assets supporting superannuation account holders between different investment types to reflect the risk and investment preferences of particular account holders.

2.40 Superannuation funds may hold units of a PST which reflect a percentage of the underlying value of the PST's pooled assets that are attributable to the superannuation fund's members' accounts. Upon deciding to merge with another fund, a superannuation fund may choose to transfer its units in the PST to the continuing fund, or the PST may transfer the assets attributable to the units in the PST to the continuing superannuation fund, another PST or a life insurance company.

2.41 Where the asset is a unit in a PST, it is the trustee of the PST that may choose the loss transfer. *[Schedule 2, Part 1, item 1, subsection 310-20(1)]*

2.42 Again, provisions are inserted to specify relevantly the same conditions and exceptions for the loss transfer where assets are held in a PST as for assets other than life insurance policies or units in a PST held by a complying superannuation fund or ADF. *[Schedule 2, Part 1, item 1, subsections 310-20(2) to (5)]*

2.43 Where appropriate the conditions are again modified to reflect that the superannuation fund holds assets via units in a PST. For example, the first condition for the PST to be eligible to choose the loss transfer is framed from the perspective of the trustee of the PST and with reference to PST units to reflect the characteristics of this form of holding superannuation fund assets. *[Schedule 2, Part 1, item 1, subsection 310-20(2)]*

2.44 The transfer of units held by a superannuation fund in a PST to another superannuation fund receives CGT relief at the fund level through the operation of section 118-350 of the ITAA 1997, which disregards a capital gain or a capital loss that arises from such transactions.

**Consequence of choosing to transfer losses**

2.45 An entity that is eligible for and chooses the loss transfer may choose to transfer certain types of losses to the continuing entity. The transfer of these losses prevents the value of the losses being extinguished upon the winding up of the transferring superannuation fund and allows accompanying members' benefits to remain intact.

2.46 The losses may be transferred to one or more of the following entities, called receiving entities:

- a continuing fund for the loss relief;
- a PST in which the units are held by a continuing fund for the loss relief just after the completion time of the arrangement to merge the funds; and/or
- a life insurance company which has issued a complying superannuation/FHSA life insurance policy that is held by a continuing fund for the loss relief just after the completion time.

*[Schedule 2, Part 1, item 1, section 310-25]*

2.47 The ability for losses to be transferred to one or more entities caters for circumstances where the transferring fund wishes to match an investment with the member preferences or for differing fund entitlements. For example, this will allow losses to be transferred to different continuing entities that provide for members with accumulation plans or defined benefit plans.

***Losses that may be transferred***

2.48 The losses that may be transferred are capital losses and revenue losses realised before the merger, specifically:

- net capital losses for earlier income years than the transfer year to the extent that they were not utilised before the completion time;
- net capital losses for the transfer year, worked out as if the transfer year ended at the completion time;
- tax losses for earlier income years than the transfer year to the extent that they were not utilised before the completion time; and
- tax losses incurred for the transfer year, worked out as if the transfer year ended at the completion time.

*[Schedule 2, Part 1, item 1, subsection 310-30(1)]*

2.49 Where the loss transfer is chosen by a life insurance company in relation to a complying superannuation/FHSA life insurance policy, the losses related to the policy are those determined by reference to capital gains, capital losses, assessable income and deductions from assets of the

complying superannuation/FHSA asset pool to the extent that the assets are reasonably attributable to the policy. An asset realised in the past may still be reasonably attributable to a policy, albeit indirectly, if for example the realised asset was previously reasonably attributable to the policy and an income tax loss it generated is still reasonably attributable to the policy. *[Schedule 2, Part 1, item 1, subsection 310-30(2)]*

2.50 Similarly, where assets include units in a PST and the loss transfer is chosen, the losses are determined by reference to the assets of the PST that are reasonably attributable to the units in the transferring superannuation fund. *[Schedule 2, Part 1, item 1, subsection 310-30(3)]*

#### ***Effect of transferring a capital loss***

2.51 The previously realised net capital loss for an income year that is not the transfer year will be taken, if it is transferred, not to have been made by the transferring entity and an amount equal to the loss will be taken to have been made by the continuing entity for that income year. *[Schedule 2, Part 1, item 1, subsection 310-35(1)]*

2.52 If the continuing entity that is receiving the net capital loss is a life insurance company, the transferred loss is taken to be a net capital loss from complying superannuation/FHSA assets. *[Schedule 2, Part 1, item 1, subparagraph 310-35(1)(b)(i)]*

2.53 A transferring entity can transfer net capital losses from the transfer income year to a continuing entity by reducing these capital losses by the amount transferred. *[Schedule 2, Part 1, item 1, paragraph 310-35(2)(b)]*

2.54 If the transferring entity is a life insurance company its capital losses from its complying superannuation/FHSA assets are reduced by the amount transferred to the continuing entity. Likewise, if the receiving entity is a life insurance company, the transferred amount of net capital losses from the transfer income year is taken to be a capital loss from complying superannuation/FHSA assets. *[Schedule 2, Part 1, item 1, paragraphs 310-35(2)(a) and (c)]*

#### ***Effect of transferring a tax loss***

2.55 Similar to capital losses, an earlier year tax loss can be transferred to a continuing entity by the transferring entity. As a result, the transferring entity will be taken not to have incurred the loss for that year and an amount equal to the loss will be taken to have been made by the continuing entity for that earlier income year. If the continuing entity is a life insurance company, the tax loss that was transferred is taken to be a tax loss of the complying superannuation/FHSA class of that earlier income year. *[Schedule 2, Part 1, item 1, subsection 310-40(1)]*

2.56 Tax losses of the transfer income year can be transferred to a continuing entity and the transferring entity must reduce their transfer year deductions by an amount equal to the transferred amount of losses. An amount equal to the transferred tax loss amount is taken to be a tax loss for the continuing entity for the transfer year. [*Schedule 2, Part 1, item 1, subsection 310-40(2)*].

2.57 Life insurance companies transferring transfer year tax losses to a receiving entity must reduce deductions covered by subsection 320-137(4) of the ITAA 1997 by an amount equal to the tax loss transferred to the continuing entity. If a life insurance company is receiving a transfer year tax loss, then the tax loss is a tax loss of the complying superannuation/FHSA class for the transfer year. [*Schedule 2, Part 1, item 1, paragraphs 310-40(2)(a) and (c)*]

### **Example 2.5**

Small Super superannuation fund has net assets of \$2 million, a carried forward net capital loss from an earlier income year of \$100,000 and tax losses for earlier income years (treated on revenue account) of \$25,000. Small Super enters into a deed of arrangement to transfer all assets and members to Best Super superannuation fund, a large APRA regulated superannuation fund, on 1 April 2009.

Small Super elects to transfer its losses. The \$100,000 carried forward capital loss and the \$25,000 revenue loss are transferred to Best Super. The losses are excluded from the calculation of Small Super's taxable income for the current year or any future income year. Best Super may include the losses in determining its taxable income for the 2008-09 income year or may carry the losses forward to future years.

### **Roll-over for assets**

2.58 Superannuation funds, ADFs, PSTs and life insurance companies that meet the eligibility conditions for the loss transfer may also choose a roll-over for assets that are to be transferred from the transferring entity to another entity (the receiving entity) under the arrangement to merge superannuation funds provided certain additional conditions are satisfied. [*Schedule 2, Part 1, item 1, subsection 310-45(1)*]

2.59 There are three additional conditions for the asset roll-over that must be satisfied.

#### ***The first condition — one or more CGT events happen to the CGT assets***

2.60 The first condition is that under the arrangement one or more CGT events (transfer events) happen resulting in the transferring entity

ceasing to hold the specified assets (the original assets). The provision does not specify the particular CGT events that may happen, but refers to CGT events generally. This ensures that the rules accommodate the wide range of transactions and CGT events that may occur. *[Schedule 2, Part 1, item 1, subsection 310-45(2)]*

2.61 The original assets of the transferring entity are described separately for the ways in which a superannuation fund may hold assets, with reference to the losses choice under the loss transfer:

- for the transferring superannuation fund or ADF, all its CGT assets for a losses choice;
- for a life insurance company, all its CGT assets reasonably attributable to the complying superannuation/FHSA life insurance policy held by the transferring superannuation fund for a losses choice just before the arrangement was made; or
- for a PST, all its CGT assets reasonably attributable to the units in that entity held by the transferring superannuation fund for a losses choice just before the arrangement was made.

*[Schedule 2, Part 1, item 1, subsection 310-45(2)]*

***The second condition — transfer events all happen in the transfer year***

2.62 The second condition is that the transfer events all happen in the year that is the transfer year for the purposes of the loss relief. That year is the income year for the transferring entity that includes the completion time for the losses choice (see paragraph 2.22 for a discussion of the completion time). *[Schedule 2, Part 1, item 1, subsection 310-45(3)]*

2.63 The second condition significantly simplifies the operation of the amendments and minimises complexity by providing that the benefits of the loss relief are only available to entities that complete their asset roll-over within a single income year. The arrangement to merge funds covers the transactions under which the assets and members are transferred between the merging funds. It does not include the planning stage, negotiations between the trustees of the funds and preparatory work to implement the arrangement.

2.64 It is expected that in most cases the transfer of members and assets will take place on a nominated effective date, or over a relatively short timeframe. The nomination of the income year as being that of the transferring entity means that the income years of the transferring entity

and the continuing entities do not need to align, catering for substituted accounting periods.

2.65 In practice the transfer of assets may take place in a number of transactions within a single income year. The asset roll-over will be available in these cases provided the other conditions for the loss relief are satisfied.

2.66 The amendments do not provide a roll-over for the fund members in respect of the exchange of their interests in the transferring fund for interests in the continuing fund because of the exemption already provided for in the existing CGT provisions. Section 118-305 of the ITAA 1997 provides an exemption for certain capital gains or capital losses in respect of members' interests in a superannuation fund.

### **Example 2.6**

Prince Super is a complying superannuation fund with 9,500 members. The trustee of Prince Super decides to merge the fund with Princess Super, a complying superannuation fund with 300,000 members.

On 6 April 2010, staff of Prince Super and Princess Super begin the preparatory work for the arrangement of the transfer of losses, assets and members from Prince Super to Princess Super. The preparatory work is finished on 10 January 2011.

The losses, assets and members of Prince Super are transferred to Princess Super in 3 tranches between 21 January 2011 and 24 February 2011. Because the transfer of assets and members occurs in a single income year it may be eligible for the loss relief.

### ***The third condition — CGT assets become assets of another complying superannuation fund, pooled superannuation trust or life insurance company***

2.67 The third condition is that the CGT assets become assets of another complying superannuation fund, a PST or a life insurance company with which a continuing fund holds a complying superannuation/FHSA policy because the transferring entity ceased to hold the CGT assets. [*Schedule 2, Part 1, item 1, subsection 310-45(4)*]

2.68 The roll-over does not have a provision relating to keeping the pre-CGT status of CGT assets. An asset has pre-CGT status if acquired before 20 September 1985. There is no need for such a provision as section 295-90 of the ITAA 1997 treats the trustee of a complying superannuation fund as having acquired on 30 June 1988 any assets it already owned on that day. An equivalent rule applies to life insurance

companies (section 320-45 of the ITAA 1997) in relation to complying superannuation/FHSA assets.

2.69 The transferring entity that chooses to obtain the roll-over must cease to hold all the CGT assets held for the benefit of its members, except for those assets retained to pay expected debts and for the entitlements of members that cannot be transferred to the continuing fund. *[Schedule 2, Part 1, item 1, subsection 310-45(5)]*

2.70 In circumstances where an entity eligible for the loss transfer chooses not to transfer losses but chooses the asset roll-over:

- the original fund for the losses choice means the fund that would have been the original fund had the loss transfer been chosen;
- the completion time for the losses choice means the time that would have been the completion time had the loss transfer been chosen; and
- the continuing fund for the losses choice means the fund that would have been the continuing fund had the loss transfer been chosen.

*[Schedule 2, Part 1, item 1, subsections 310-45(2) to (4)]*

***Transfer of assets held by a life insurance company***

2.71 A life insurance company choosing the asset roll-over must cease to hold all the assets reasonably attributable to a complying superannuation/FHSA life insurance policy held by the superannuation fund that is transferring its members to the continuing fund. *[Schedule 2, Part 1, item 1, paragraph 310-45(2)(b)]*

2.72 Such assets must be transferred to the continuing superannuation fund, another PST or life insurance company. *[Schedule 2, Part 1, item 1, subsection 310-45(4)]*

2.73 The nature of a life insurance policy will mean that it may not be possible to directly attribute particular assets in a life insurance company to any one particular life insurance policy held by a superannuation fund. To overcome this problem, the assets subject to the asset roll-over (the original assets) are described as the assets of the life insurance company reasonably attributable to the relevant complying superannuation/FHSA life insurance policy of the superannuation fund and reflected in its value. To distinguish such assets, it is expected that a portion of the assets of the life insurance company's complying superannuation/FHSA asset pool could be identified, including by reference to normal industry practice, as

being reasonably attributable to a particular policy and reflected in its value. In addition there are provisions in the superannuation industry supervision law that require member benefits to be protected where there is a merger of superannuation entities, for example SIS Reg 1994, Regulation 6.29. This protection would ensure in these circumstances that an appropriate portion of the assets of the life insurance company would be transferred under the merger. *[Schedule 2, Part 1, item 1, paragraph 310-45(2)(b)]*

2.74 The transferring life insurance company may retain assets that it requires to pay existing or expected debts relating to the transfer of assets and to meet its liabilities in respect of individuals who have remained members of the original fund because of circumstances outside the control of the trustee of the fund. *[Schedule 2, Part 1, item 1, subsection 310-45(5)]*

***Transfer of assets held by a pooled superannuation trust***

2.75 The asset roll-over will allow for the assets held within a PST whose value is reasonably attributable to units of the original fund to be transferred to the continuing fund, another PST or life insurance company without extinguishing the losses associated with those assets. *[Schedule 2, Part 1, item 1, paragraph 310-45(2)(c) and subsection 310-45(4)]*

2.76 The nature of a pooled investment will mean that it will not be possible to directly attribute particular assets in the pool to the interest of a particular superannuation fund. To overcome this problem, the assets subject to the asset roll-over are the assets in the pool that are reasonably attributable to the investment of the superannuation fund. To distinguish such assets, it is expected that a portion of the PST's assets could be identified, including by reference to ordinary industry practice, as reasonably attributable to a particular fund's interest in the PST. *[Schedule 2, Part 1, item 1, paragraph 310-45(2)(c)]*

2.77 A PST choosing the asset roll-over must cease to hold all the assets whose value is reasonably attributable to the units of the original complying superannuation fund that is transferring its members to the continuing superannuation fund. *[Schedule 2, Part 1, item 1, paragraph 310-45(2)(c)]*

2.78 Such assets must be transferred to the continuing superannuation fund, another PST or life insurance company. *[Schedule 2, item 1, subsection 310-45(4)]*

2.79 The transferring PST may retain assets that it requires to pay existing or expected debts relating to the transfer of assets and to meet its liabilities in respect of individuals who have remained members of the original fund because of circumstances outside the control of the trustee of the fund. *[Schedule 2, Part 1, item 1, subsection 310-45(5)]*

### ***Choosing the form of the asset roll-over***

2.80 An entity that is eligible for the asset roll-over may, depending on its circumstances, be able to choose between the two methods for executing the roll-over. These two methods provide flexibility and minimise compliance costs for such entities. The consequences for both the transferring entity and continuing entity of each of these methods are specified in paragraphs 2.84 to 2.87 and paragraphs 2.88 to 2.92 respectively.

2.81 If an entity is in a net capital loss position in relation to the transferred assets for the current year, it may choose either the global asset approach or the individual asset approach. This net capital loss position of the entity is determined by subtracting the capital gains on the assets from the capital losses on the assets. Where the result exceeds zero, the entity has a net capital loss position on those assets. *[Schedule 2, Part 1, item 1, subsection 310-50(1)]*.

2.82 If the entity is not in a net capital loss position in relation to transferred assets it can only choose the individual asset approach. *[Schedule 2, Part 1, item 1, subsection 310-50(1)]*

2.83 An entity that can choose either the global asset approach or individual asset approach to transfer its CGT assets must use one method only in relation to all its transferred assets. The entity cannot use the individual asset approach in relation to some of the transferred assets and the global asset approach in relation to the remaining transferred assets. *[Schedule 2, Part 1, item 1, subsection 310-50(1)]*

### **Example 2.7**

Brown Super is eligible for the loss relief and wants to transfer its assets to Orange Super. In doing so, Brown Super wants to take advantage of the asset roll-over in order to preserve the value of unrealised losses in its CGT assets.

Brown Super holds four different types of assets:

- 20,000 shares in Shelley Co, each of which has a reduced cost base of \$25 and a current market value of \$17;
- 40,000 shares in Big Mining Co, each of which has a reduced cost base of \$40 and a current market value of \$29;
- 80,000 shares in Little Mining Co, each of which has a cost base of \$9 and a current market value of \$15; and
- 5,000 units in Great Property Trust, each of which has a reduced cost base of \$30 and a current market value of \$26.

In order to work out whether Brown Super can choose the global asset approach or the individual asset approach, Brown Super adds up any capital losses it would have for the transferred assets and subtracts any capital gains it would have for the transferred assets.

Brown Super would have total capital losses of \$620,000 and total capital gains of \$480,000.

Subtracting the capital gains from the capital losses results in \$140,000 — a result more than zero. This means that Brown Super can choose either the global asset approach or the individual asset approach for the transfer of its assets.

However, Brown Super cannot choose the global asset approach to apply to some of its assets and the individual asset approach to apply to the rest.

### ***Consequences for CGT assets — global asset approach***

2.84 A superannuation fund that qualifies for the global asset approach may elect to treat those assets subject to the asset roll-over as being transferred (or disposed of) to the continuing entity by treating:

- the assets that would otherwise realise a capital gain as being transferred at their cost base; and
- the assets that would otherwise realise a capital loss as being transferred at their reduced cost base.

*[Schedule 2, Part 1, item 1, subsection 310-55(1)]*

2.85 The effect of these rules is that the transferred CGT assets will have neither a capital gain nor a capital loss on their transfer.

2.86 For the continuing entity, the first element of the cost base and reduced cost base of the transferred asset in its hands is taken to be equal to the cost base and the reduced cost base respectively of the asset just before its transfer (when it was still held by the transferring entity).

*[Schedule 2, Part 1, item 1, subsections 310-55(2) and (3)]*

### **Example 2.8**

Effort Super is a complying superannuation fund with 10 members. Effort Super enters into a deed of arrangement to transfer all of its assets and members to Big Super, a complying superannuation fund with 1,000 members.

At the time of the transfer of assets, Effort Super has shares in Beagle Co whose total market value exceeds their total cost base by

\$25,000; and shares in Rufus Co whose total market value exceeds their total cost base by \$50,000. Effort Super also has shares in Ugly Duckling with an unrealised loss of \$100,000.

Because Effort Super's unrealised capital losses exceed its unrealised capital gains, it can choose to roll over all the capital gains and the capital losses on its shares to Big Super. In effect, Effort Super will roll over a net unrealised loss of \$25,000 to Big Super.

2.87 The rules for the transfer of revenue assets are explained in paragraphs 2.93 to 2.100.

***Consequences for CGT assets — individual asset approach***

2.88 The other method that a superannuation fund may use if it is in a net capital loss position and it chooses not to use the global asset approach is the individual asset approach. However, a fund must use the individual asset approach if it is not in a net capital loss position in relation to transferred assets. Under this approach, the transferring entity may disregard all the capital losses it realises, or it may choose to disregard some or none of its capital losses. The choice as to what losses to disregard is a matter for the transferring fund. Any capital gains realised on transferred assets are not disregarded. [*Schedule 2, Part 1, item 1, subsection 310-60(1)*]

- For example, the fund may choose not to disregard some realised capital losses when these losses could be used to offset any capital gains that may also be realised under the merger. The fund could choose to disregard any remaining capital losses that are realised under the merger and transfer the attributes of those assets to the receiving fund.

2.89 If the transferring fund uses the individual asset approach, the capital proceeds received on the disposal or transfer of the assets to the continuing entity that are subject to the roll-over will be taken to be equal to the reduced cost base of the asset in the hands of the transferring fund. [*Schedule 2, Part 1, item 1, subsections 310-60(2) to (4)*]

**Example 2.9**

Green Super is a complying superannuation fund with 10,000 members. It holds various assets, some of which have unrealised capital gains while others have unrealised capital losses. The trustee of Green Super considers merging with Yellow Super members. This merger would be achieved by Green Super transferring its assets and 10,000 members to Yellow Super before being wound up.

Among its assets, Green Super owns 50,000 shares in Bull Ltd, acquired on 18 July 2004.

The cost base for each of these shares is \$2 (total cost base of \$100,000) and at the time of the transfer the shares in Bull Ltd are each worth \$5. The transfer of these shares would therefore realise a capital gain of \$150,000 for Green Super.

- Total capital proceeds less total cost base equals total capital gain.
- $(50,000 \text{ shares} \times \$5 \text{ capital proceeds}) - (50,000 \text{ shares} \times \$2 \text{ cost base}) = \$150,000 \text{ capital gain.}$

Green Super also owns 100,000 shares in Bear Ltd. These shares were acquired on 28 September 2007. The reduced cost base for each of these shares is \$10 (total reduced cost base of \$1 million) and at the time of the transfer they are worth \$5 each. The transfer of these shares would therefore realise a capital loss of \$500,000 for Green Super.

- Total reduced cost base less total capital proceeds equals total capital loss.
- $(100,000 \text{ shares} \times \$10 \text{ reduced cost base}) - (100,000 \text{ shares} \times \$5 \text{ notional capital proceeds}) = \$500,000 \text{ capital loss.}$

Green Super subsequently transfers its assets and members' accounts to Yellow Super and is wound up.

The trustee of Green Super may choose either the global asset approach or the individual asset approach as the fund is in a net loss position (\$350,000). The trustee chooses the individual asset approach.

The trustee now has the choice either to transfer all or realise some of the capital losses applicable to its Bear Ltd shares. Suppose the trustee decides to realise some of these losses to eliminate the capital gains arising on the transfer of the Bull Ltd shares. The trustee would therefore choose to realise the capital losses on 30,000 Bear Ltd shares by not choosing the roll-over for each of these shares, which would produce a total capital loss of \$150,000. This would eliminate the \$150,000 capital gain on the Bull Ltd shares.

The trustee of Green Super would transfer the remaining 70,000 Bear Ltd shares to the trustee of Yellow Super and choose the asset roll-over in relation to each of these shares. Under the asset roll-over rules, the trustee of Green Super is taken to receive capital proceeds for each of these 70,000 shares equal to their reduced cost base of \$10.

In this way, the trustee of Green Super has avoided any capital gains on assets transferred as part of the merger by not choosing the roll-over on some of the capital loss assets. The trustee of Green Super chose the roll-over in relation to the remaining capital loss assets to preserve their losses under the merger — with the total capital losses preserved being \$350,000.

2.90 If the asset roll-over is chosen by the transferring superannuation fund, the first element of the cost base and reduced cost base of the corresponding received asset in the hands of the receiving entity is taken to be an amount equal to the cost base and reduced cost base, respectively, of the original asset in the hands of the transferring fund just before the transfer of assets. *[Schedule 2, Part 1, item 1, subsections 310-60(4) and (5)]*

2.91 A consequential amendment is made to ensure that, for CGT assets transferred from the transferring entity to the continuing entity that benefit from the roll-over, the 12 month ownership period requirement for the CGT discount will commence from the date when the transferring entity acquired such assets (see paragraph 2.118).

### **Example 2.10**

Further to Example 2.9, for Yellow Super the first element of the reduced cost base of the shares in Bear Ltd transferred to Yellow Super would be \$10. Suppose the cost base of each of the shares in Bear Ltd that were transferred to Yellow Super was \$12 just before the transfer. For Yellow Super, the first element of the cost base of each of the Bear Ltd shares transferred to it would be \$12.

As the capital gains on the shares in Bull Ltd were realised under the merger, the first element of the cost base and reduced cost base of each of the Bull Ltd shares transferred to Yellow Super would be determined under Division 110 of the ITAA 1997 as modified by Division 112 of the ITAA 1997.

Yellow Super will be taken to have acquired the shares in Bear Ltd on 28 September 2007. The shares in Bull Ltd will be acquired by Yellow Super on the day of their transfer because they were not subject to the roll-over.

2.92 If the asset roll-over is not chosen by the transferring superannuation fund, the fund will realise an overall loss on the disposal of the assets. This loss may be able to be transferred to the continuing fund under the loss transfer rules.

### **Example 2.11**

Further to Example 2.10, Green Super may choose to dispose of all its shares in Bull Ltd and Bear Ltd. In this case Green Super would have a realised net loss on the assets to be transferred equal to \$350,000.

Under the arrangement to merge the funds, Green Super may transfer the \$350,000 loss to Yellow Super.

### **Consequences of the roll-over for revenue assets**

2.93 CGT assets that are revenue assets may be transferred under an arrangement that is eligible for the loss roll-over. A revenue asset is defined in section 977-50 of the ITAA 1997 as an asset for which a profit or loss on disposal or ceasing to own the asset is taken into account in calculating assessable income other than as a capital gain or loss and is neither trading stock nor a depreciating asset.

2.94 The transferring fund will be able to choose the global asset approach or the individual asset approach for the transfer of revenue assets if the entity is in a net loss position in respect of those assets. This choice reduces the compliance impact for the transferring superannuation fund. *[Schedule 2, Part 1, item 1, subsection 310-50(2)]*

2.95 The tax loss is worked out as if the current year ended at the completion time of the transfer. The net loss position in respect of CGT assets that are revenue assets is determined by subtracting the amounts that would be included in the transferring fund's assessable income as a result of the transfer from the amounts that the entity would be able to deduct as a result of the transfer. Where the result exceeds zero, the fund has a net loss on those assets and may choose the global asset approach. *[Schedule 2, Part 1, item 1, subsection 310-50(2)]*

#### ***Global approach for revenue assets***

2.96 Under the global asset approach, the transferring fund's gross proceeds for the transfer of each revenue asset will be taken to be the amount, the deemed proceeds, it would need to have received to have no profit or loss from the transfer. This rule means that there is no gain or loss for the transferring fund. *[Schedule 2, Part 1, item 1, subsection 310-65(1)]*

2.97 The continuing fund will be taken to have paid an amount equal to the deemed proceeds for the transferring fund for each revenue asset received. These rules together provide the roll-over for transferred revenue assets. *[Schedule 2, Part 1, item 1, subsection 310-65(2)]*

### **Example 2.12**

Further to Example 2.8, suppose Effort Super has bonds issued by Beagle Co. The total market value of these bonds is \$245,000 and the total cost is \$220,000, producing an unrealised net gain of \$25,000.

Effort Super also has a loan to Rufus Co. The market value of the loan is \$95,000 and its cost is \$145,000, producing an unrealised net loss of \$50,000.

As there is a net revenue loss, Effort Super may elect to roll-over the bonds and the loan asset under the global asset approach to Big Super thereby rolling over its net revenue loss of \$25,000.

Big Super will be taken to have acquired the loan asset for \$145,000 and each bond for \$220,000 divided by the number of bonds (because all the bonds had been purchased by Effort Super for the same cost).

### ***Individual asset approach for revenue assets***

2.98 Where the transferring fund is not in a net loss position in respect of the transferred revenue assets, the fund must use the individual asset approach, which has particular consequences for the transferring entity and the continuing entity. [*Schedule 2, Part 1, item 1, subsections 310-50(2) and 310-70(1)*]

2.99 The transferring entity may choose to disregard any tax loss arising from the transfer event. In these cases, the transferring entity's gross proceeds for the transfer event are taken to be the amount (deemed proceeds) the transferring entity would need to have received to have a nil profit and a nil loss for the event. [*Schedule 2, Part 1, item 1, subsections 310-70(1) and (2)*]

2.100 The consequences for the continuing entity are that the entity is taken to have paid an amount for the received asset at the time of the transfer equal to the deemed proceeds of the transferring entity. This rule effectively transfers the asset to the continuing entity with its cost attributes from the transferring entity. The deemed proceeds will then be the cost from which any subsequent gain or loss to the continuing entity will be calculated. [*Schedule 2, Part 1, item 1, subsection 310-70(2)*]

### **Example 2.13**

Further to Example 2.12, Effort Super chooses the individual asset approach rather than the global asset approach in respect of the assets it transfers to Big Super.

Effort Super has a choice to roll over the unrealised loss on the loan to Rufus Co. If Effort Super chooses to do so, the loan asset would be

taken to be transferred for an amount equal to its cost of \$145,000, thereby ensuring there is a nil profit and a nil loss for Effort Super for the transfer.

Big Super is taken to have paid an amount for the loan asset equal to the amount deemed to have been received by Effort Super for the asset (that is, \$145,000). This rolls over the unrealised revenue loss of \$50,000 on the loan asset.

The bonds issued by Beagle Co that Effort Super owns would be realised under the merger with Big Super so that Effort Super would realise a capital gain of \$25,000.

### **Further consequences for a transferring entity or receiving entity that is a life insurance company**

2.101 Where a complying superannuation/FHSA asset is transferred from a life insurance company, or an asset (in relation to a complying superannuation policy) is transferred to a life insurance company, it is necessary to consider not just the tax consequences of the transfer between separate entities, but also any deemed sales of assets for market value under section 320-200 of the ITAA 1997. These may arise when assets are transferred to and from the complying superannuation/FHSA asset pools of life insurance companies.

2.102 The amendments will provide that section 320-200 does not apply in relation to asset realisations subject to the asset roll-over. This is to ensure that the effect of the roll-over is not unintentionally overridden by a deemed market value sale of the asset. *[Schedule 2, Part 1, item 1, subsection 310-75(1)]*

2.103 Similarly, where the receiving entity is a life insurance company, the relevant received assets will be taken to be complying superannuation/FHSA assets of the company, and not be a life insurance premium. This latter rule, which broadly resembles sections 320-315 and 320-320 of the ITAA 1997 that apply to life insurance business transfers, is to ensure that the Division 320 life insurance business taxation provisions do not override the loss relief that these amendments provide. *[Schedule 2, Part 1, item 1, subsection 310-75(2)]*

2.104 These modifications to the life insurance taxation rules ensure that they apply appropriately in respect of rolled-over assets. They will apply only to assets which are actually rolled over to the life insurance company, and not to other transferred assets.

2.105 The combined effect of the two rules is to preserve the effect of the roll-over, to ensure that assets with unrealised gains and losses that accrued in a 15 per cent tax rate environment in the transferring entity are rolled into the equivalently taxed complying superannuation/FHSA asset pool of the recipient entity, and to enable the rolled-over assets to be appropriately recognised by the fee and charge mechanisms of Division 320 of the ITAA 1997.

### **Method for making the choice to transfer loss or roll-over asset**

2.106 The transferring entity's choice to use a particular method for calculating the losses transferred or assets subject to the roll-over will be evidenced by the manner in which it completes its income tax return for the income year in which the transfer occurs. The choice of roll-over by the transferring entity will have specific consequences for the continuing entity. However, both parties to the transaction are not required to elect the roll-over. Rather, it is expected that the eligibility for the loss relief and the consequences for the continuing entity would be considered by both parties during the negotiation of the transfer. [*Schedule 2, Part 1, item 1, section 310-85*]

2.107 Section 103-25 provides the mechanism for making elections in respect of the CGT provisions. These rules will apply to the new loss transfer and asset roll-over arrangements.

### **Consequences of the roll-over for depreciating assets**

2.108 Superannuation funds may also hold assets that are depreciating assets. The disposal of a depreciating asset (that is, the asset is transferred to the continuing entity) will cause a balancing adjustment event (as defined by section 40-295 of the ITAA 1997) to occur. A balancing adjustment event may require the taxpayer disposing of the depreciating asset to adjust their taxable income.

2.109 Where there is a difference between the asset's termination value (that is, the final sale price) and its adjustable value (that is, the original cost less the decline in value while it was held by the taxpayer), a balancing adjustment may be assessable or deductible under section 40-285 of the ITAA 1997. However, section 40-285 will not apply if the roll-over provided by section 40-340 of the ITAA 1997 applies. No balancing adjustment is required if the section 40-340 roll-over applies.

2.110 An entity will be eligible for the section 40-340 roll-over if it satisfies three conditions. These conditions are:

- there is a balancing adjustment event caused by the disposal of a depreciating asset;
- the disposal involves a CGT event; and
- one of the CGT roll-overs listed in the table in subsection 40-340(1) of the ITAA 1997 is chosen or automatically applies.

2.111 The roll-over provided in section 40-340 allows the entity to defer the balancing adjustment until a further balancing adjustment event. This permits the continuing entity to claim deductions for the depreciating asset which has been transferred to it. This means that the transfer of the asset from the transferring entity to the continuing entity will not extinguish the value of future depreciation deductions already built into the value of members' interests.

2.112 An amendment will be made to subsection 40-340(1) of the ITAA 1997 so that the transfer of a depreciating asset from the transferring entity to the continuing entity under an arrangement to merge superannuation funds for which loss relief is chosen qualifies for the roll-over provided by section 40-340 of the ITAA 1997. [*Schedule 2, Part 2, item 2*]

## **Application and transitional provisions**

2.113 The amendments apply in relation to transfer events that happen on or after 24 December 2008 and before 1 July 2011. [*Schedule 2, Part 3, item 11*]

## **Repeals and savings provisions**

### ***Repeals***

2.114 These amendments end on 30 June 2011. An automatic repeal provision is included for these amendments. The repeal will occur two years after the end date of the legislation. [*Schedule 2, Part 4, items 12 to 21*]

### ***Savings provisions***

2.115 These amendments will operate for a limited time and are then automatically repealed. Savings provisions are inserted into the amending law to ensure that the full legal and administrative consequences are preserved for the period of its operation after the provisions are repealed. *[Schedule 2, Part 5, items 22 to 26]*

## **Consequential amendments**

2.116 A number of consequential amendments are made to ensure that the new loss relief provisions interact appropriately with the existing law.

2.117 The list of provisions which modify the cost base of a CGT asset is amended to include the new CGT loss relief provisions. *[Schedule 2, Part 2, item 3]*

2.118 This Bill amends subsection 115-30(1) (special rules about acquisition times for the CGT discount) of the ITAA 1997. This amendment ensures that, for CGT assets transferred from the transferring entity to the continuing entity for a roll-over under Division 310, the 12-month ownership period requirement for the CGT discount commences from the date when the transferring entity acquired the asset. *[Schedule 2, Part 2, item 4]*

2.119 The general provisions which specify the capital proceeds for CGT events A1, C2 and E2 are modified in respect of transactions arising from the transfer of assets covered by the CGT loss roll-over, as the roll-over rules specify the capital proceeds in those cases. *[Schedule 2, Part 2, items 5 to 8]*

2.120 The provisions which specify the notice requirements to enable a member in a fund to obtain a deduction for a personal contribution are amended so that a member of a fund that has merged with a continuing fund may provide the necessary notice. The rules which provide for the variation of the notice are also amended. *[Schedule 2, Part 2, items 9 and 10]*

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## **Chapter 3**

# ***Exempt annuity business of life insurance companies***

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### **Outline of chapter**

3.1 Schedule 3 to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to clarify the circumstances in which income derived by life insurance companies in respect of immediate annuity business qualifies as non-assessable non-exempt income.

### **Context of amendments**

3.2 The income derived by life insurance companies in respect of immediate annuity business is non-assessable non-exempt income. Immediate annuity business is business that supports life insurance policies that provide for an annuity that is currently payable. This includes immediate annuity policies that are purchased with rolled-over superannuation benefits.

3.3 The rationale for exempting life insurance companies in relation to immediate annuity business is to prevent double taxation. That is, as the policyholder is taxable on the annuity income received, the life insurance company is exempt from tax.

3.4 The exemption for immediate annuity business applies only to income that relates to immediate annuities that meet certain conditions (the annuity conditions). The purpose of the annuity conditions is to prevent the excessive deferral of tax on income derived by life insurance companies that relates to immediate annuity policies.

3.5 The annuity conditions were transferred from the *Income Tax Assessment Act 1936* (ITAA 1936) to the ITAA 1997 in 2000. The intention of the rewrite was to replicate the annuity conditions. However, concerns have been raised that anomalies arise because of modifications to the wording of the annuity conditions as a result of that rewrite.

3.6 These concerns were compounded when the annuity conditions were modified to reflect the Simplified Superannuation changes, which commenced from the 2007-08 income year. One of those changes was to

make superannuation income streams exempt from tax in most cases. Superannuation income streams are regulated under the *Superannuation Industry (Supervision) Act 1993*. In these circumstances, it is not appropriate to continue to apply the annuity conditions to immediate annuity policies that provide for superannuation income streams.

## **Summary of new law**

3.7 The amendments will clarify the circumstances in which income derived by life insurance companies in respect of immediate annuity business qualifies as non-assessable non-exempt income.

3.8 First, from 1 July 2000, the amendments will ensure that the annuity conditions in the ITAA 1997 are consistent with the former annuity conditions in the ITAA 1936. To achieve this, the annuity conditions have been rewritten to make the law clearer and to clarify the circumstances in which the annuity conditions apply.

3.9 Second, from the 2007-08 income year, the amendments:

- ensure that the annuity conditions do not apply to immediate annuity policies that provide for superannuation income streams; and
- modify the annuity conditions to update terminology as a consequence of the Simplified Superannuation changes.

## Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<p>With effect from 1 July 2000, the annuity conditions will be, broadly, that:</p> <ul style="list-style-type: none"> <li>• the annuity contract does not permit the residual capital value of the annuity to exceed, broadly, its purchase price;</li> <li>• if the annuity contract provides that the annuity is payable until the end of a term of <i>years certain</i>, then the contract does not permit the total commutation payments to exceed, broadly, the remaining amount of the annuity's purchase price;</li> <li>• if the annuity contract: <ul style="list-style-type: none"> <li>– provides that the annuity is payable until the death of a person (or of the death of the last of two or more persons to die) or until the end of a term of <i>years certain</i>; and</li> <li>– permits one or more commutation payments to become payable before the end of a term of <i>years certain</i>,</li> </ul> then the contract does not permit the total of those commutation payments to exceed, broadly, the remaining amount of the annuity's purchase price; and</li> <li>• there is no unreasonable deferral of payments of annuity income to policyholders, having regard to certain specified matters.</li> </ul> <p>With effect from the 2007-08 income year, the annuity conditions will not apply to immediate annuity policies that provide for superannuation income streams.</p>	<p>The income derived by life insurance companies in respect of immediate annuity policies that satisfy the annuity conditions is non-assessable non-exempt income.</p> <p>The annuity conditions apply, broadly, to:</p> <ul style="list-style-type: none"> <li>• an annuity purchased with a rolled-over superannuation benefit before 10 December 1987; and</li> <li>• any annuity (including an annuity that provides for a superannuation income stream) purchased after 9 December 1987.</li> </ul> <p>The current annuity conditions are, broadly, that:</p> <ul style="list-style-type: none"> <li>• the annuity must be payable until the later of the death of a person (or of the death of the last of two or more persons to die) and the end of a fixed term;</li> <li>• the annuity contract does not permit the total commutation payments to exceed, broadly, the remaining amount of the annuity's purchase price;</li> <li>• the annuity contract does not permit the residual capital value of the annuity to exceed, broadly, its purchase price; and</li> <li>• there is no unreasonable deferral of payments of annuity income to policyholders, having regard to certain specified matters.</li> </ul>

## **Detailed explanation of new law**

3.10 The income derived by life insurance companies in respect of immediate annuity policies that satisfy the annuity conditions is non-assessable non-exempt income.

3.11 The annuity conditions apply, broadly, to:

- an annuity purchased with a rolled-over superannuation benefit before 10 December 1987; and
- any annuity (including an annuity that provides for a superannuation income stream) purchased after 9 December 1987.

3.12 The amendments:

- from 1 July 2000, clarify the operation of the annuity conditions; and
- from the 2007-08 income year:
  - ensure that the annuity conditions do not apply to immediate annuity policies that provide for superannuation income streams; and
  - modify the annuity conditions to update terminology as a consequence of the Simplified Superannuation changes.

## **Clarify the operation of the annuity conditions (from 1 July 2000)**

3.13 The annuity conditions are being rewritten, with effect from 1 July 2000, to clarify their operation and ensure that they are consistent with the former annuity conditions in the ITAA 1936.

3.14 These changes are a rewrite of the former annuity conditions in the ITAA 1936. Changes to the wording or style used in the rewritten provisions are not intended to change the law as it operated prior to 1 July 2000.

### ***Annuity condition 1***

3.15 The first annuity condition applies if there is a residual capital value in relation to an immediate annuity. [*Schedule 3, items 1 and 2, subparagraphs 320-246(1)(e)(ii) and (iii) and item 1 in the table in subsection 320-246(3)*]

3.16 The term ‘residual capital value’ was formerly defined in section 27A of the ITAA 1936 to mean, broadly, the amount that is payable under an annuity contract when the annuity contract is terminated or comes to an end.

3.17 The condition is that the contract under which the annuity is payable does not permit the residual capital value to exceed the annuity’s purchase price. [*Schedule 3, item 2, item 1 in the table in subsection 320-246(3)*]

### ***Annuity condition 2***

3.18 The second annuity condition applies if the contract under which the annuity is payable provides that the annuity is payable until the end of a term of *years certain* — that is, broadly, for the fixed term. [*Schedule 3, items 1 and 2, subparagraphs 320-246(1)(e)(ii) and (iii) and item 2 in the table in subsection 320-246(3)*]

3.19 The condition is that the contract does not permit the total of the amounts paid for the annuity’s commutation (whether in whole or in part) to exceed the annuity’s reduced purchase price. [*Schedule 3, item 2, item 2 in the table in subsection 320-246(3)*]

3.20 A commutation is essentially the process of converting an annuity into a lump sum.

3.21 The term ‘reduced purchase price’ was formerly defined in section 27A of the ITAA 1936 to mean, broadly, the purchase price of the annuity to the extent that it has not been treated for income tax purposes as having been effectively returned to the policyholder in annuity payments that have been paid.

### ***Annuity condition 3***

3.22 The third annuity condition applies if the contract under which the annuity is payable:

- provides that the annuity is payable until the later of:
  - the death of a person (or of the death of the last of two or more persons to die); or
  - the end of a term of *years certain*; and

- permits one or more commutation payments to become payable before the end of a term of *years certain* for the annuity's commutation (whether in whole or in part).

*[Schedule 3, items 1 and 2, subparagraphs 320-246(1)(e)(ii) and (iii) and item 3 in the table in subsection 320-246(3)]*

3.23 The condition is that the contract does not permit the total of the commutation payments that may become payable before the end of the term of *years certain* (broadly, before the end of the fixed term period of the annuity) to exceed the annuity's reduced purchase price. *[Schedule 3, item 2, item 3 in the table in subsection 320-246(3)]*

#### ***Annuity condition 4***

3.24 The fourth annuity condition applies to all immediate annuity contracts which are subject to the annuity conditions. *[Schedule 3, items 1 and 2, subparagraphs 320-246(1)(e)(ii) and (iii) and item 4 in the table in subsection 320-246(3)]*

3.25 The condition is that there is no unreasonable deferral of the payments of the immediate annuity, having regard to:

- to the extent to which the payments depend on the returns of the investment of the assets of the life insurance company paying the annuity — when the payments are made and when those returns are derived;
- to the extent to which the payments do not depend on those returns — the relative sizes of the annual totals of the payments from year to year; and
- any other relevant factors.

*[Schedule 3, item 2, item 4 in the table in subsection 320-246(3)]*

#### **Annuity conditions do not apply to superannuation income streams (from the 2007-08 income year)**

3.26 The purpose of the annuity conditions is to prevent the excessive deferral of tax on income derived by life insurance companies that relates to immediate annuity policies.

3.27 As a result of the Simplified Superannuation changes, superannuation income streams are exempt from tax in most cases. Superannuation income streams are regulated under the *Superannuation Industry (Supervision) Act 1993*.

3.28 In these circumstances the annuity conditions will cease to apply to immediate annuity policies that provide for superannuation income streams.

3.29 Therefore, with effect from the 2007-08 income year, an exempt life insurance policy will include, so far as is relevant, a life insurance policy that provides for an immediate annuity that:

- was purchased on or before 9 December 1987;
- is a superannuation income stream; or
- satisfies the relevant approved annuity conditions.

*[Schedule 3, items 4 and 5, paragraph 320-246(1)(e)]*

### **Update terminology to reflect the Simplified Superannuation changes (from the 2007-08 income year)**

3.30 A number of terms which are used in the annuity conditions were modified when the Simplified Superannuation changes were introduced.

3.31 Therefore, with effect from the 2007-08 income year, the annuity conditions are modified to reflect these changes in terminology. That is:

- in item 1 in the table in subsection 320-246(3), the reference to section 27A of the ITAA 1936 is changed to section 27H of the ITAA 1936; and
- in items 2 and 3 in the table in subsection 320-246(3), the references to reduced purchase price (within the meaning of section 27A of the ITAA 1936) are changed to purchase price (within the meaning of section 27H of the ITAA 1936), reduced by the sum of the deductible amounts excluded from assessable income under that section.

*[Schedule 3, items 6 to 8, subsection 320-246(3)]*

## **Application and transitional provisions**

### **Amendments which apply from 1 July 2000**

3.32 The amendments to rewrite the annuity conditions to clarify their operation and ensure that they are consistent with the former annuity conditions in the ITAA 1936 commence from 1 July 2000 — that is, from the commencement of the new taxation regime for taxing life insurance companies.

3.33 These amendments are beneficial to life insurance companies that conduct immediate annuity business and to immediate annuity policyholders as they address concerns that unintended anomalies could arise under the current wording of the annuity conditions. During the consultation process on these amendments, key stakeholders sought for the amendments to commence from 1 July 2000 primarily to reduce compliance costs.

### **Amendments which apply from the 2007-08 income year**

#### *Annuity conditions do not apply to superannuation income streams*

3.34 The amendments to ensure that the annuity conditions do not apply to immediate annuity policies that provide for superannuation income streams apply from the 2007-08 income year — that is, from the commencement of the Simplified Superannuation changes. [*Schedule 3, item 11*]

3.35 These amendments are beneficial to life insurance companies that conduct immediate annuity business and to policyholders who receive superannuation income streams as they remove an additional layer of rules that need to be complied with.

#### *Update terminology to reflect the Simplified Superannuation changes*

3.36 The amendments to modify the annuity conditions to update terminology as a consequence of the Simplified Superannuation changes apply from the 2007-08 income year — that is, from the commencement of the Simplified Superannuation changes. [*Schedule 3, item 11*]

3.37 These amendments are of a minor technical nature to ensure that the income tax law operates effectively.

## **Consequential amendments**

3.38 Consequential amendments will repeal the following amendments:

- a technical correction that was made in 2006 to paragraph 320-246(5)(a);
- amendments that were made in 2007 as part of the Simplified Superannuation changes to:
  - modify paragraph 320-246(1)(e) (including an amendment that inserted subparagraph 320-246(1)(e)(iv));
  - modify paragraph 320-246(4)(a); and
  - insert section 320-246 in the *Income Tax (Transitional Provisions) Act 1997*.

*[Schedule 3, items 3, 9 and 10]*



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# **Chapter 4**

## ***Deductible gift recipients***

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### **Outline of chapter**

4.1 Schedule 4 to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to update the list of deductible gift recipients (DGRs) to include two new entities, and change the name of one entity.

### **Context of amendments**

4.2 The income tax law allows taxpayers who make gifts of \$2 or more to DGRs to claim income tax deductions. To be a DGR, an organisation must fall within one of the general categories set out in Division 30 of the ITAA 1997, or be listed by name under that Division.

4.3 DGR status assists eligible funds and organisations to attract public support for their activities.

### **Summary of new law**

4.4 The amendments add two organisations to the list of specifically listed DGRs, and change the name of one. Gifts of \$2 or more that are made to organisations that are specifically listed, are tax deductible.

### **Detailed explanation of new law**

4.5 Schedule 4 allows deductions for gifts to the organisations listed in Table 4.1. [*Schedule 4, item 3, items 3.2.12 and 3.2.13 in the table in subsection 30-40(2)*]

**Table 4.1**

<i>Name of Fund</i>	<i>Date of effect</i>	<i>Special conditions</i>
The Green Institute Limited	24 June 2009	Gifts to this fund can be made after 23 June 2009.
United States Studies Centre Limited	27 July 2009	Gifts to this fund can be made after 26 July 2009.

4.6 The Green Institute Limited provides a forum for education, exchange, research and debate on the principles of environment, social justice, non-violence and democracy. The key aim of the Green Institute is to promote those principles through training, networking, and research and policy development.

4.7 The United States Studies Centre Limited was established to promote friendship, cooperation and understanding between the peoples of the United States, Australia and New Zealand; and strengthen relations between these countries through creating a better understanding of their cultures and societies. It aims to research, debate and create new knowledge on American political, economic, social and cultural issues.

4.8 Schedule 4 changes the name of the organisation listed in table 4.2. [*Schedule 4, item 1, item 2.2.21 in the table in subsection 30-25(2)*]

**Table 4.2**

<i>Current name of fund</i>	<i>New name of fund</i>	<i>Date of effect</i>
Dymocks Literacy Foundation Limited	Dymocks Children's Charities Limited	4 June 2009

## **Application and transitional provisions**

4.9 The amendments listing the organisations named in Table 4.1 apply from the dates of effect shown in the table.

## **Consequential amendments**

4.10 A number of changes have been made to update the index to include the new entities. [*Schedule 4, items 2, 4 and 5, section 30-315*]

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## **Chapter 5**

# ***Income Recovery Subsidy for the North Western Queensland floods***

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### **Outline of chapter**

5.1 Schedule 5 to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to ensure that the Income Recovery Subsidy for the North Western Queensland floods is exempt from income tax and to ensure the Subsidy is not included in 'separate net income' for the purposes of calculating an entitlement to certain tax offsets.

### **Context of amendments**

5.2 The Income Recovery Subsidy for the North Western Queensland floods was announced as an emergency measure by the Minister for Families, Housing, Community Services and Indigenous Affairs in Parliament on 25 February 2009.

5.3 The Income Recovery Subsidy is available to Australian residents over 16 years of age, who have experienced a loss of income as a direct result of the North Western Queensland Floods.

5.4 The Subsidy will compliment the range of services, payments and assistance already available to those affected by these floods.

5.5 This measure will retrospectively exempt from income tax, payments made in the 2008-09 income year. The payment could be claimed after 24 February 2009.

5.6 Such payments would also normally be included in the calculation of 'separate net income'. The calculation of separate net income can affect a taxpayer's eligibility for certain tax offsets.

5.7 Exempting these payments from income tax and separate net income will lessen the financial hardship experienced by those individuals and communities affected by the North Western Queensland floods of January and February 2009.

## Summary of new law

5.8 This measure provides that no income tax will be paid by recipients on the receipt of the Income Recovery Subsidy in respect to the North Western Queensland Floods. This measure will apply retrospectively for the 2008-09 income year.

5.9 This measure amends:

- subsection 159J(6) of the *Income Tax Assessment Act 1936* (ITAA 1936) (as it existed prior to 1 July 2009) to exclude the Income Recovery Subsidy from the definition of ‘separate net income’; and
- section 51-30 of the ITAA 1997 to list the Income Recovery Subsidy as exempt from income tax.

## Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
The Income Recovery Subsidy for the North Western Queensland floods is expressly exempt from income tax.	Under the current law, payments made to recipients of the Income Recovery Subsidy for the North Western Queensland floods may be subject to income tax.

## Detailed explanation of new law

### Exclude the Income Recovery Subsidy from the definition of separate net income

5.10 Section 159J of the ITAA 1936 (as it existed prior to 1 July 2009) provides that a taxpayer may be eligible to an offset of tax when they contribute to the maintenance of a dependant person, but that the amount of that offset will be reduced as a dependant’s separate net income increases.

5.11 The amendment to subsection 159J(6) of the ITAA 1936 will exclude the Income Recovery Subsidy from the definition of separate net income. [*Schedule 5, item 1*]

5.12 The amendment will mean that an individual otherwise entitled to an offset under section 159J of the ITAA 1936, will still be entitled to the same offset, despite any Income Recovery Subsidy received by their dependants.

### **Exempt the Income Recovery Subsidy from income tax**

5.13 Section 51-30 of the ITAA 1997 lists welfare recipients and payments that are exempt from income tax.

5.14 The amendment to section 51-30 of the ITAA 1997 will make the Income Recovery Subsidy exempt from income tax. *[Schedule 5, item 3, item 5.4 in the table in section 51-30]*

5.15 Section 11-15 of the ITAA 1997 is an index of income which is exempt from income tax only if it is derived by certain entities. This index will be amended to include the Income Recovery Subsidy as an exempt payment. *[Schedule 5, item 2, section 11-15]*

### **Application and transitional provisions**

5.16 This measure applies retrospectively for the 2008-09 income year.

5.17 As such, these payments will be subject to the provisions of the ITAA 1997 dealing with amounts of exempt income.



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## Chapter 6

# Excise manufacture and spirits

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### Outline of chapter

6.1 Schedule 6 to this Bill amends the *Excise Act 1901* (the Excise Act) to specifically deem the blending of spirits to produce spirit as excise manufacture for the purposes of the Excise Act.

6.2 This is necessary for imported high strength neutral spirit, as it currently derives its concessional duty treatment (that is, a ‘free’ rate of excise duty) from being blended with domestic high strength neutral spirit and entering the excise system.

### Context of amendments

6.3 ‘Excise manufacture’ is the production or manufacture in Australia, of goods specified in the Schedule to the *Excise Tariff Act 1921* (Excise Tariff). ‘Manufacture’ is taken to include a process that involved the provision of knowledge, the application of skills, experiences or services of labour which results in the conversion of materials into a saleable commodity. The commodity must be different from the inputs which went into making it.

6.4 The concessional spirits regime is a mechanism under the Excise Tariff which allows domestic high strength neutral spirit to be delivered into the domestic market at a ‘free’ rate of duty. This is generally high strength neutral spirit for ‘a specified industrial, manufacturing, scientific, medical, veterinary or educational purpose’. There is no mechanism which allows imported high strength neutral spirit to be directly delivered into the domestic market without payment of duty.

6.5 Currently, importers of high strength neutral spirit blend or mix imported product with domestic excisable high strength neutral spirit. In the case of imported high strength neutral spirit, this blending results in its transfer into the excise system and the extinguishment of any customs liability other than any *ad valorem* component that must be paid. The entirety of the excisable high strength neutral spirit blend, which includes the imported component, is then delivered into the domestic market at a ‘free’ rate of duty under the concessional spirit regime.

6.6 There are provisions in the Excise Act which specifically deem the blending of fuel to constitute excise manufacture. However, there is no explicit provision in the Excise Act to ensure that blending spirits to produce spirit is excise manufacture. This Bill amends the Excise Act by inserting an equivalent provision to ensure that blending spirits, including imported and domestic high strength neutral spirit, to produce spirit constitutes excise manufacture.

## **Summary of new law**

6.7 The new subsections 77FM(1) and (4) of the Excise Act have a similar effect to section 77G, which relates to fuel blending, and deems spirit blending to produce spirit to constitute manufacture. This will mean blending which results in an item that is classifiable to item 3 of the Excise Tariff (spirits) is excise manufacture. This will cover the blending of spirits for an industrial, manufacturing, scientific, medical, veterinary or educational purpose.

6.8 The new subsections 77FM(2) and (3) have a similar effect to subsections 77H(3) and (4), relating to fuel blending exemptions, and allows the Commissioner of Taxation (Commissioner) to make determinations by legislative instrument that exempt certain activities from constituting excise manufacture.

## **Comparison of current and new law**

<i>New law</i>	<i>Current law</i>
Subsections 77FM(1) and (4) specifically deem the blending of spirits to produce spirit to constitute excise manufacture.	There is no equivalent provision in the Excise Act for spirits.
Subsections 77FM(2) and (3) allow the Commissioner to exclude certain activities from constituting excise manufacture by legislative instrument.	There is no equivalent provision in the Excise Act for spirits.

## **Detailed explanation of new law**

6.9 The new subsections 77FM(1) and (4) deem spirit blending to produce spirit to constitute manufacture. This means that blending resulting in a spirit that is classifiable to item 3 of the Excise Tariff is

excise manufacture. This includes spirits for an industrial, manufacturing, scientific, medical, veterinary or educational purpose. This will maintain the status quo for the concessional spirits regime and ensure that blending of spirits to produce spirits for industrial, manufacturing, scientific, medical, veterinary or educational purposes is delivered into the domestic market at a 'free' rate of duty.

6.10 The new subsections 77FM(2) and (3) allow the Commissioner to make determinations by legislative instrument that exempt certain activities from constituting excise manufacture. Any determination made will be a legislative instrument under the *Legislative Instruments Act 2003*. Excluding blending operations via a legislative instrument prevents the Excise Act from becoming unnecessarily complex. Making a determination will ensure that certain approved end users of spirits will not fall into the excise system and then be subject to licensing requirements. The sorts of blending that could be covered by the determination include where incidental or remnant blending occurs in a tank or container.

## **Application and transitional provisions**

6.11 The amendments commence from the date of Royal Assent.



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