
Chapter #

Loss roll-over for merging superannuation funds

Outline of chapter

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

Context of amendments

1.2 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 ITAA 1997).

1.3 The transfer of assets from one superannuation entity to another, under a merger between the two entities, will typically trigger CGT event A1 (section 104-10 of the ITAA 1997) or may trigger CGT event E2 (section 104-60 of the ITAA 1997) and the realisation of capital gains or capital losses for the original fund as appropriate. Following this asset transfer and the transfer of members' accounts to the receiving fund, the original fund will typically be wound up.

1.4 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 original superannuation fund following the asset and member transfer.

1.5 Similarly, revenue losses, such as foreign exchange losses, are also extinguished on the ending of an entity. Revenue losses have a value

as they can be offset against income, or carried forward where the entity continues to exist. However, where there is a merger and the original entity ceases to exist, the value of the revenue losses are also extinguished.

1.6 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.

1.7 This loss roll-over encompasses transfers to and from pooled superannuation trusts (PSTs) and life insurance policies held by superannuation funds as well as superannuation funds. Providing the loss roll-over to superannuation fund mergers involving these kinds of superannuation 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.

1.8 In the current financial climate, it is important that potential barriers to a robust and efficient superannuation industry are minimised. Given the recent global financial market turmoil, this measure will ensure the efficiency and robustness of the superannuation system.

1.9 Capital gains do not have the same disincentive impact. Superannuation funds typically include the tax cost of any unrealised capital gains and may include the tax benefit of any unrealised capital losses 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

1.10 Schedule # amends the ITAA 1997 by inserting Division 310. This Division allows a complying superannuation fund to choose to roll-over capital losses and revenue losses arising from the merger of the fund with another complying superannuation fund with five or more members. The original fund may also transfer (roll-over) previously

realised capital losses and revenue losses, including prior year capital losses held in the original superannuation fund.

1.11 The Division allows for two different options for the asset roll-over depending on the net gain or loss position of the entity. An entity can choose either the global asset approach, if eligible, or the individual asset approach. The global asset approach will be available if the original entity is in a net capital loss position for the current year.

1.12 Specifically, Subdivision 310-B sets out what entities are eligible for the roll-over and Subdivisions 310-C and 310-D set out the consequences of the roll-over for these entities.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
Capital losses and revenue losses realised from the merger of a complying superannuation fund with another complying superannuation fund with five or more members may be rolled-over under the merger using either of two methods: <ul style="list-style-type: none">• global asset approach; or• individual asset approach.	Capital losses and revenue losses realised from such a merger cannot be transferred and are lost when the original superannuation fund is wound up.
Previously realised capital losses and revenue losses may be transferred to another entity where all the assets of a superannuation fund are transferred to that other entity.	Previously realised capital losses and revenue losses may not be transferred under a merger of the entities.

Detailed explanation of new law

When an entity is eligible for the loss roll-over

1.13 New provisions are inserted into the ITAA 1997 to specify the conditions for eligibility for the optional loss roll-over. Rules to specify the consequences for the various types of losses and assets are described later below at paragraphs 1.46 to 1.91.

1.14 The primary condition is that all the assets of a superannuation fund or of a PST or life insurance company that support a superannuation

fund, must be transferred to another superannuation fund that is an Australian Prudential Regulation Authority (APRA) regulated complying superannuation entity, or to a PST or complying superannuation business of a life insurance company to support a superannuation fund, which has at least five members prior to the transfer.

1.15 The first specific requirement is that one or more CGT events happen because the complying superannuation fund ceases to hold all its CGT assets. The provision does not specify the particular CGT events that may happen, but takes the approach of referring to CGT events generally. This ensures that the rules accommodate the wide range of transactions and CGT events that may occur.

1.16 The second specific requirement is that the CGT assets become held by another complying superannuation fund, a PST or a life insurance company (the continuing entity) because the original entity ceased to hold the CGT assets.

1.17 The satisfaction by the original superannuation provider of the eligibility rules for the loss roll-over does not of itself authorise the particular merger or transfer transaction. Taxpayers would need to consider the applicable governing trust deeds and legislation. This may include prudential regulatory requirements for the proposed transaction, for example the requirements of the *Superannuation Industry (Superannuation) Act 1993* (SIS Act 1993) and the Superannuation Industry (Supervision) Regulations 1994, such as the rules protecting member entitlements in the continuing superannuation entity.

1.18 The roll-over does not have a provision relating to keeping 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.

1.19 Also, the amendments do not provide a roll-over for the exchange of members' interests in the funds 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.

Continuing entities

1.20 The roll-over will be available where:

- the original superannuation fund holds assets directly and those assets are transferred; or

- the original superannuation fund holds units in a PST and the assets that support the units are transferred; or
- the original superannuation fund holds a life insurance policy and the assets that support the life insurance policy are transferred.

[Schedule, Part 1, item 1, section 310-10]

1.21 The roll-over provisions for the transfer of assets and losses from each of these three superannuation entities are specified separately for clarity. These transactions may involve transfers of assets and losses from either a superannuation fund, a PST or a life insurance company to support a superannuation fund, to any of those three types of superannuation entities.

Example 1.1

Apple Super is a complying superannuation fund with 10,000 members. The trustee of Apple Super considers merging Apple Super with Lime Super, a complying superannuation fund with 50,000 members.

Under the merger, Apple Super would transfer all of its assets and members to Lime Super before winding up. Apple Super would qualify for the loss roll-over if it transfers all its assets to Lime Super and ceases to have any members just after the transfer.

Example 1.2

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 would dispose of all its assets and give the proceeds to Hot Super which uses the proceeds to purchase additional units in the Jalapeno PST. Warm Super would qualify for the loss roll-over if it transfers all its assets to Hot Super and ceases to have any members just after the transfer.

Transfer of assets from a complying superannuation fund

1.22 The roll-over will be available to a complying superannuation fund where the eligibility requirements specified above are satisfied.

1.23 A small superannuation fund is defined in section 995-1 of the ITAA 1997 as being a complying superannuation fund with four or fewer members.

1.24 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.

1.25 The loss roll-over may be available in circumstances where a SMSF merges with a large APRA regulated superannuation fund. However, it will not be available in the case where the two funds are SMSFs (as defined) before the merger. The successor superannuation fund must be a complying large APRA regulated fund immediately before the transfer of assets. *[Schedule, Part 1, item 1, 310-10]*

Pooled Superannuation Trusts (PSTs)

1.26 The trustee of a PST will be able to obtain the roll-over where the eligibility requirements set out in paragraphs 1.13 to 1.16 are satisfied. PSTs may be used by superannuation funds to indirectly hold the investment assets which their members derive benefits from. 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.

1.27 Superannuation funds may hold units of a PST which reflect a percentage of the underlying value of the PST's pooled assets attributable to the superannuation fund's member. Upon deciding to merge with another fund, a superannuation fund may choose to transfer their units in the PST to the continuing fund, or the PST may transfer the assets supporting the units in the PST to the continuing superannuation fund, another PST or a life insurance company.

1.28 The roll-over will allow for the assets held within a PST which support the units of the fund to be transferred to the continuing fund, another PST or life insurance company without extinguishing the losses associated with those assets.

1.29 The nature of a pooled investment will mean that it may not be possible to attribute particular assets in the pool to the interest of a particular superannuation fund. To overcome this problem, the assets subject to the roll-over are described as the assets in the pool that 'support' the investment of the superannuation fund. It is expected that a portion of the PST's assets could be identified, including by reference to ordinary industry practice, which could reasonably be regarded as

supporting a particular fund's interest in the PST. 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 Superannuation Industry Supervision Regulations 1994, regulation 6.29.

1.30 The transfer of units in the 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 the transaction. The disregarded capital gains and losses may not be transferred under the loss roll-over as there is no gain or loss subject to CGT to be rolled-over due to the exemption mechanism. [*Schedule, Part 1, item 1, section 310-15*]

Life Insurance Companies

1.31 Superannuation funds may hold life insurance policies issued by life insurance companies in order to draw upon the investment capabilities offered by life insurance companies.

1.32 As part of their merger with the continuing fund the original superannuation fund may transfer their life insurance policy, to the continuing fund or request the insurance company to transfer the assets that supported their policy to the continuing fund, PST or another life insurance company.

1.33 The life insurance company will be able to use the roll-over where upon cancellation of the life insurance policy the assets which previously supported the policy are transferred from the complying superannuation/first home saver account (FHSA) asset pool of a life insurance company to an eligible entity. The complying superannuation/FHSA asset pool comprises the assets of a life insurance business that are segregated from other assets for the purpose of discharging its complying superannuation/FHSA liabilities. The roll-over will preserve the value of the losses associated with the assets that supported the policy held by the superannuation fund.

1.34 As is the case for assets held in a PST, the nature of a life insurance policy will mean that it may not be possible to attribute particular assets in the life insurance company to the interest of a particular superannuation fund in the insurance policy. To overcome this problem, the assets subject to the roll-over are described as the assets of the life insurance company that 'support' the life insurance policy of the superannuation fund. Similarly, 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, which could reasonably be regarded as supporting a particular policy.

1.35 The transfer or novation of the life insurance policy to the continuing superannuation fund may receive CGT relief for the original fund through the operation of section 118-300 of the ITAA 1997, which disregards a capital gain or a capital loss that arises from the transaction. *[Schedule, Part 1, item 1, section 310-20]*

1.36 The original life insurance company may retain certain assets that it requires to pay existing or expected debts relating to the transfer of assets. *[Schedule, Part 1, item 1, subsections 310-15(2) and 310-20(2)]*

Example 1.3

JOH Ltd is a complying superannuation fund which manages, as trustee, the superannuation funds for two large employers Yellow Super and Mauve Super.

JOH transfers all the assets and members of Yellow Super and Mauve Super from the superannuation funds to a life insurance policy which is part of the complying superannuation business of a life insurance company, Bountiful Life. JOH also satisfies the other requirements for the roll-over. JOH will be able to obtain the roll-over and transfer the capital losses and revenue losses of Yellow Super and Mauve Super to Bountiful Life.

Transfer of assets

1.37 The original superannuation fund 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.

1.38 The CGT assets, the ‘identical assets’, are the CGT assets held by the original superannuation entity just before the first transfer event excluding any assets needed to pay existing or expected debts. The ‘identical assets’ must be transferred to the continuing superannuation fund, PST or life insurance company. *[Schedule, Part 1, item 1, paragraph 310-10(1)(c)]*

1.39 A PST choosing the roll-over must cease to hold all the assets that support the units of the original complying superannuation fund that is transferring its members to the continuing superannuation fund.

1.40 The PST’s ‘identical assets’ are those assets which supported the units held by the original superannuation fund in the PST, excluding any assets which need to be retained to pay existing or expected debts arising due to the transfer of assets. These ‘identical assets’ must be transferred

to the continuing superannuation fund, another PST or life insurance company. *[Schedule, Part 1, item 1, paragraph 310-15(1)(c)]*

1.41 A life insurance company choosing the roll-over must cease to hold all the assets that supported a life insurance policy held by the original superannuation fund that is transferring its members to the continuing fund.

1.42 The life insurance company's 'identical assets' are those assets which supported the policy held by the original superannuation fund, excluding any assets which need to be retained to pay existing or expected debts arising due to the transfer of assets. These 'identical assets' must be transferred to the continuing superannuation fund, PST or another life insurance company. *[Schedule, Part 1, item 1, paragraph 310-20(1)(c)]*

1.43 For the original superannuation fund, a PST or life insurance company, the transfer of all the identical assets may occur in more than one transaction but must occur within a single income year. This simplifies the operation of the measure and minimises complexity.

Transfer of members

1.44 The original superannuation fund must have no members at the completion of the transfer of assets. This requirement ensures that the roll-over is available in circumstances where funds are merging with each other for the purpose of superannuation industry consolidation. The roll-over is not available for routine transfers of assets between funds where both funds continue to have members.

Consequence of the roll-over for losses

Superannuation funds

1.45 Trustees of superannuation entities that satisfy the eligibility rules described above for the loss roll-over 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 superannuation fund and allows accompanying members' benefits to remain intact.

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

- net capital losses (if any) for earlier income years than the current year;

- net capital loss (if any) for the current year, worked out as if the current year ended at the completion of the merger;
- tax losses (if any) for earlier income years than the current year; and
- tax loss (if any) for the current year, worked out as if the current year ended at the completion of the merger.

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

1.47 The previously realised net capital loss for an income year that is transferred will be taken to not have been made by the original entity and an amount equal to the loss will be taken to have been made by the continuing entity for that income year. The losses are thereby preserved rather than being extinguished when the original entity is wound up.

[Schedule, Part 1, item 1, subsection 310-25(2)]

1.48 Similarly, a transferred tax loss that is not a capital loss for an income year will be taken to not have been made by the original entity and an amount equal to the loss will be taken to have been made by the continuing entity for that income year. *[Schedule, Part 1, item 1, subsection 310-25(3)]*

1.49 Tax losses from the current year which are a result of the transfer of assets under the merger of superannuation entities are transferred to the continuing superannuation provider through the roll-over of assets mechanism described below at paragraphs 1.54 to 1.90.

1.50 Losses transferred to the continuing entity are taken to be incurred in the income year in which the original entity originally incurred or made the loss and may only be offset against income of the continuing entity.

Example 1.4

Small Super superannuation fund has net assets of \$2 million, a carried forward net capital loss from the 2008-09 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 roll-over 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 2008-09 or may carry the losses forward to future years.

Example 1.5

Black Super is a complying superannuation fund with 1,000 members. The trustee of Black Super considers merging with White Super, a complying superannuation fund with 100,000 members. This merger would be achieved by Black Super transferring its 1,000 members to White Super before being wound up.

Black Super owns 50,000 shares in Down Ltd. The cost base for each of these shares is \$10 (total cost base of \$500,000) and at the time of the transfer the shares are each worth \$5 (total market value of \$250,000). Should it transfer all of these shares, Black Super would realise a capital loss of \$250,000.

However, under the merger arrangement, White Super agrees to receive 10,000 shares in Down Ltd and the proceeds from the sale of the remaining 40,000 shares in Down Ltd as a \$200,000 cash contribution.

Black Super subsequently qualifies for the loss roll over and chooses to:

- transfer the losses it realises from the sale of its 40,000 shares in Down Ltd to White Super; and
- roll over the embedded losses in the 10,000 shares in Down Ltd that it transfers to White Super.

The consequences of these transactions are set out below.

Black Super sells 40,000 shares in Down Ltd to a third party for \$5 each and, assuming it incurs no transaction costs, realises a capital loss of \$5 for each share (total capital loss of \$200,000).

Black Super transfers 10,000 shares in Down Ltd. Under these amendments, Black Super is taken to receive capital proceeds of \$10 for each share (total capital proceeds of \$100,000). As a result, Black Super realises a capital gain of nil.

Black Super realises no other capital gain or losses that year and has a net capital loss of \$200,000. Black Super transfers this net capital loss to White Super.

PSTs and life insurance companies

1.51 For PSTs and life insurance companies that choose the roll-over, net capital losses and tax losses associated with assets that supported the complying superannuation fund's units in the PST or life insurance policy can be transferred to the continuing superannuation fund.

1.52 The losses that may be transferred from a PST or life insurance company to a continuing superannuation fund are:

- net capital losses of the original entity (if any) for earlier income years than the current year;
- net capital loss of the original entity (if any) for the current year, worked out as if the current year ended at the completion of the merger;
- tax losses of the original entity (if any) for earlier income years than the current year; and
- any tax loss of the original entity (if any) for the current year, worked out as if the current year ended at the completion of the merger.

[Schedule, Part 1, item 1, sections 310-30 and 310-35]

1.53 Any such losses of the original PST or life insurance company for an income year that are transferred will be taken to not have been made by the original entity and an amount equal to the loss will be taken to have been made by the continuing entity for that income year. This transfers the value of the losses to the continuing entity when the original complying superannuation fund which held the relevant PST units or life insurance policy in the original entity no longer has any members.

[Schedule, Part 1, item 1, subsections 310-30(2) and 310-35(2)]

Consequences of the roll-over for CGT assets

1.54 Superannuation entities will be able to roll-over the losses on CGT assets using either of two methods, depending on the net gain or loss position of the entity. These two methods are specified to provide flexibility and minimise compliance costs for original entities. The consequences for both the original entity and continuing entity from choosing either approach are specified in paragraphs 1.57 to 1.62 and paragraphs 1.63 to 1.67 respectively.

1.55 The original entity may choose to use either the global asset approach, if eligible, or the individual asset approach. To be eligible for the global asset approach the original entity must have a net capital loss for the current year. If the original entity is not in a net loss position, then it can only use the individual asset approach. *[Schedule, Part 1, item 1, section 310-45]*

1.56 An original entity in the position to choose to use either the global asset approach or individual asset approach to transfer their CGT

assets must choose to use one method only in relation to all of their 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 some of the other transferred assets. *[Schedule, Part 1, item 1, subsection 310-45(2)]*

Consequences for CGT assets – global asset approach

1.57 An original superannuation fund that is in a net capital loss position on its CGT assets that are not subject to revenue gains or losses immediately before the first transfer of assets to the continuing entity may elect to treat those assets as being disposed of or transferred to the continuing entity globally by:

- treating the assets that would otherwise realise a capital gain as being disposed of or transferred at their cost base; and
- treating the assets for which there is a capital loss as being disposed of or transferred at their reduced cost base.

1.58 The operation of the roll-over provisions will mean that the original entity will have no net capital gain or capital loss for the income year. The choice of applying the global asset approach is available where the original entity would have had a net capital loss if it had ceased to own all its assets and did not apply the roll-over provisions. *[Schedule, Part 1, item 1, subsection 310-50(1)]*

1.59 The effect of these rules is that the CGT event happening to the transferred CGT assets will have a capital gain of nil.

1.60 The transfer of a CGT asset under the global approach will have consequences for the original entity and the continuing entity which preserve the value of the unrealised capital loss. These rules provide the roll-over mechanism for CGT assets.

1.61 For the continuing entity, the cost base and reduced cost base of the transferred identical asset in the hands of the continuing entity is taken to be the cost base or reduced cost base of the asset just before the transfer event (when it was still held by the original entity). This preserves the unrealised capital loss in the asset when it is held by the continuing entity. *[Schedule, Part 1, item 1, subsections 310-50(2) and (3)]*

Example 1.6

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

The asset roll-over rules will permit Effort Super to elect to roll-over all the shares to Big Super, both those with both capital gains and those with capital losses, thereby rolling over a net unrealised loss of \$25,000.

1.62 These rules for the transfer of revenue assets are explained at paragraphs 1.68 to 1.75.

Consequences for CGT assets – individual asset approach

1.63 The other method that a superannuation entity may use if it is in a net loss position, but must use if it is in a net gain position overall, is the individual asset approach. Under this approach the original entity may disregard all the capital losses it realises, or it may choose to disregard some or none of the capital losses. The choice as to what losses to disregard is a matter for the original fund. *[Schedule, Part 1, item 1, subsection 310-55(1)]*

- For example, the fund may choose to not disregard some realised capital losses when these losses can 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.

1.64 If the original entity 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 original entity. *[Schedule, Part 1, item 1, subsection 310-55(3)]*

Example 1.7

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. Yellow Super is a complying superannuation fund with 100,000 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.

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

Green Super also owns 100,000 shares in Bear Ltd. These shares were acquired on 21 February 2007. The reduced cost base for each of these shares is \$10 (total reduced cost base of \$1,000,000) 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 capital proceeds less total reduced cost base equals total capital loss.
- $(100,000 \text{ shares} \times \$5 \text{ notional capital proceeds}) - (100,000 \text{ shares} \times \$10 \text{ reduced cost base}) = \$500,000 \text{ capital loss.}$

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

1.65 The transferring fund may choose to disregard all the capital losses it realises, or it may choose to disregard some or none of the capital losses. The choice as to what losses to disregard is a matter for the original fund. The original fund may choose to not disregard some realised capital losses when these losses can 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.

Example 1.8

Further to Example 1.7, the transfer of shares in Bull Ltd would realise a capital gain of \$150,000 for Green Super and the transfer of all 100,000 shares in Bear Ltd would realise a capital loss of \$500,000.

Consequently, the trustees of Green Super choose to disregard only the capital losses realised on 70,000 shares in Bear Ltd (and subsequently chooses not to disregard the capital losses that are realised on 30,000 shares in Bear Ltd). This allows Green Super to realise a \$150,000 capital loss (that can offset the \$150,000 capital gain realised from the transfer of its 50,000 shares in Bull Ltd).

- Total capital proceeds less total reduced cost base equals total capital loss.

- $(30,000 \text{ shares} \times \$5 \text{ notional capital proceeds}) - (30,000 \text{ shares} \times \$10 \text{ reduced cost base}) = \$150,000 \text{ capital loss.}$
- The capital losses realised from the transfer of the remaining 70,000 shares in Bear Ltd to Yellow Super are disregarded.

Yellow Super would then be able to realise the losses on these shares. Consequently the losses will not be extinguished when Green Super is wound up.

1.66 For the continuing entity, the corresponding identical asset's cost base or reduced cost base will be equal to the reduced cost base of the asset in the hands of the original entity just before the transfer event. *[Schedule, Part 1, item 1, subsections 310-55(4) and (5)]*

1.67 If the roll-over is not chosen by the original superannuation fund, the fund will realise a loss on the disposal of the asset. This loss will be extinguished if the superannuation fund is subsequently wound up.

Consequences of the roll-over for revenue assets

1.68 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.

1.69 Similar to CGT assets that are not assets on revenue account, the original entity will be able to choose the global asset approach or the individual asset approach for the transfer of revenue assets if the entity has a tax loss for the current year. As in the case of CGT assets that receive CGT treatment, this choice reduces the compliance impact for the original superannuation entity. *[Schedule, Part 1, item 1, subsection 310-60]*

1.70 The tax loss is worked out as if the current year ended at the completion time of the transfer. *[Schedule, Part 1, item 1, subsection 310-60(1)]*

Global approach for revenue assets

1.71 Where the original entity would have realised a tax loss in relation to all the transferred assets, and other assessable income and allowable deductions arising up to the completion time, then the entity may choose the global asset approach in relation to all of those assets. Under this approach, the original entity's gross proceeds for the transfer will be taken to be the amount, the deemed proceeds, the original entity would need to have received to have no profit or loss from the CGT event.

This rule means that there is no gain or loss for the original entity.
[Schedule, Part 1, item 1, section 310-65]

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

Example 1.9

Further to example 1.6, Effort Super has bonds issued by Beagle Co. the market value of which exceeds the cost base by \$25,000 and a loan to Rufus Co. the market value of which is less than the cost base by \$50,000.

The loss roll-over rules will permit Effort Super to elect to roll-over all the shares to Big Super, those with both capital gains and capital losses as thereby rolling over the net capital loss of \$25,000.

Individual asset approach for revenue assets

1.73 Where the original fund does not have a tax loss in respect of all the transferred assets, the fund must use the individual asset approach, which has particular consequences for the original entity and the continuing entity. *[Schedule, Part 1, item 1, subsection 310-70(1)]*

1.74 The original entity may disregard any tax loss for the transfer event. The original entity's gross proceeds for the transfer event are taken to be the amount (deemed proceeds) the original entity would need to have received to have a nil profit and a nil loss for the event. These rules provide the roll-over for the original entity. *[Schedule, Part 1, item 1, subsections 310-70(1) to (3)]*

1.75 The consequences for the continuing entity are that the entity is taken to have paid an amount for the corresponding identical asset at the time of the transfer equal to the deemed proceeds of the original asset. This rule effectively transfers the asset to the continuing entity with its cost attributes from the original entity. The deemed proceeds will then be the cost from which any subsequent gain or loss to the continuing entity will be calculated. *[Schedule, Part 1, item 1, subsection 310-70(4)]*

Consequences of the roll-over for depreciating assets

1.76 Superannuation funds may also hold assets that are depreciating assets. The disposal of a depreciating asset (ie, 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. Generally, a balancing adjustment event will occur when:

- a taxpayer stops holding the asset;
- a taxpayer stops using the asset;
- a taxpayer never used the asset; or
- there was a partial change in ownership of the asset.

1.77 A balancing adjustment event may require the taxpayer disposing of the depreciating asset to adjust their taxable income.

1.78 Balancing adjustments make sure that a taxpayer's total deductions for the depreciation of the asset, as well as any balancing adjustments, are consistent with the taxpayer's actual loss coming from the asset's acquisition and subsequent disposal.

1.79 A balancing adjustment amount is the difference between the 'termination value' of the asset and the 'adjustable value' of the asset determined just before the balancing adjustment event happened.

1.80 Where there is a difference between the asset's termination value (ie, the final sale price) and its adjustable value (ie, 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. 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

1.81 An entity will be eligible for the roll-over if it satisfies three conditions specified by section 40-340. 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 CGT roll-overs listed in the table in subsection 40-340(1) of the ITAA 1997 is satisfied.

1.82 The roll-over provided in section 40-340 will allow the original entity to defer the balancing adjustment until a further balancing adjustment event allowing 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 original entity to the continuing entity will not extinguish the value of future depreciations already built into the value of members' interests.

1.83 An amendment will be made to subsection 40-340(1) of the ITAA 1997 so that the transfer of a depreciating asset which forms part of the transfer of the identical assets from the original entity to the continuing entity qualifies for the roll-over provided by section 40-340 of the ITAA 1997. *[Schedule , Part 2, item 2, subsection 40-340(1)]*

Consequences of the roll-over for Division 230 financial arrangements

1.84 The assets held by a superannuation entity that elects to roll-over may include assets which satisfy the definition of a financial arrangement within the meaning of Division 230 of the ITAA 1997 concerning the taxation of financial arrangements (TOFA) provisions. The roll-over for these assets is the same as those for revenue assets generally as described in paragraphs 1.68 to 1.75.

Example 1.10

Super Fund A has a Division 230 financial arrangement to which the fair value election applies. The cost of the asset is \$100, and no amount has yet been included in assessable income in relation to the financial arrangement.

At the time of the merger the fair value of the asset is \$130. If Super Fund A chooses the roll-over, the proceeds on the transfer will be \$100 while the Division 230 starting value is \$130.

Under section 310-75 as the starting value is more than the capital proceeds there is an excess and the continuing entity is required to include in its assessable income an amount equal to 25 per cent of the difference that is \$7.50, in the current year and each of the following three years.

1.85 These assets may receive TOFA treatment in the hands of either or both the original and continuing entity. Although due to the \$100 million threshold for TOFA it will generally be the continuing entity that could be subject to TOFA.

1.86 The TOFA provisions generally apply to a superannuation fund with financial assets of \$100 million or more, or assets of \$300 million or more.

1.87 The TOFA provisions allow taxpayers to elect a number of different methods for accounting for gains and losses on TOFA assets, primarily based on determining the time at which amounts are to be included in the assessable income of the entity. The TOFA methods are:

- Subdivision 230-B (accruals or realisation methods)

- Subdivision 230-C (fair value method);
- Subdivision 230-D (foreign exchange retranslation method);
- Subdivision 230-E (hedging financial arrangement method);
and
- Subdivision 230-F (reliance on financial reports method).

1.88 Apart from the accruals or realisation methods, the tax value of the asset in the hands of the continuing entity may differ for the other three elective methods from the value to the original entity. In the absence of rules to adjust for the difference, the roll-over of the asset will not give the appropriate outcome.

1.89 New provisions are inserted to adjust the value of CGT assets that are rolled-over under the new provisions for superannuation entities that merge and that receive TOFA treatment to ensure that the difference is taken into account in working out the tax consequences of the roll-over for the continuing entity at the completion time.

1.90 The difference between the value of the assets due to the application of the TOFA provisions will be accounted for in the current income year and the three following income years. *[Schedule, Part 1, item 1, section 310-75]*

Example 1.11

Small Super holds a financial arrangement as part of its assets. The asset has a \$100,000 book value to Small Super.

Max Super is a large superannuation fund which is subject to TOFA as it has financial assets exceeding \$100 million. Max Super has elected to use the fair value method for accounting for this type of asset. When the asset is transferred from Small Super to Max Super the roll-over will treat Max Super as having acquired the asset for \$100,000.

However, Max Super uses the fair value elective method for valuing financial arrangements. The fair value of the asset is \$120,000. The difference in the value of the asset in the hands of Small Super compared to Max Super would result in a lesser capital gain being realised on the later disposal.

The difference of \$20,000 between the roll-over value and fair value is included in the assessable income of Max Super in the current and the three succeeding income years — \$5,000 in the current year and \$5,000 in each of the three following years.

Method for making the choice to roll over

1.91 The original entity's choice to use a particular method for calculating the capital losses transferred will be evidenced by the manner in which they complete their income tax return for the income year in which the transfer occurs. The choice of roll-over by the original entity will have specific consequences for the continuing entity. However, the roll-over provisions will not require both parties to the transaction to elect the roll-over. Rather, it is expected that the eligibility for the roll-over and the consequences for the continuing entity would be considered by both parties during the negotiation of the transfer.

1.92 Section 103-25 provides the mechanism for making elections in respect of the CGT provisions. These rules will apply to the new loss roll-over arrangements. *[Schedule, Part 1, item 1, section 310-80]*

Application and transitional provisions

1.93 The amendments apply in relation to transfer events that happen on or after 24 December 2008 and on or before 30 June 2011. *[Schedule, Part 3, item 8]*

Repeals and savings provisions

Repeals

1.94 The end date of the legislation is 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, Part 4, items 9 to 16]*

Savings provisions

1.95 As the roll-over will operate for a limited time and is 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, Part 5, items 17 to 21]*

Consequential amendments

1.96 A number of consequential amendments are made to ensure that the new roll-over provisions interact appropriately with the existing law.

1.97 The list of provisions which modify the cost base of a CGT asset is amended to include the new CGT loss roll-over provisions. *[Schedule, Part 2, item 3 section 112-97 (table items 31 and 32)]*

1.98 The general provisions which specify the capital proceeds for CGT events A1, C2 and E2 are switched off 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, Part 2, items 4 to 7]*