



LCG 2016/D8 - Superannuation reform: transfer balance cap and transition-to-retirement reforms: transitional CGT relief for superannuation funds

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Superannuation reform: transfer balance cap and transition-to-retirement reforms: transitional CGT relief for superannuation funds

Relying on this draft Guideline

This draft Guideline describes how the Commissioner proposes to apply the CGT relief reforms in Schedule 1, Part 3 of the [Treasury Laws Amendment \(Fair and Sustainable Superannuation\) Bill 2016](#) when it comes into effect. If the Bill is enacted without amendment, this Guideline will be a public ruling when the Bill comes into effect to entities that rely on it in good faith.

If you rely on this draft Guideline in good faith, you will not have to pay any underpaid tax, penalties or interest in respect of matters covered by the draft Guideline if it does not correctly state how a relevant provision applies to you.

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What this draft Guideline is about

1. This draft Guideline provides guidance on the transitional CGT relief for superannuation funds where assets supporting superannuation income streams are reallocated or reapportioned to accumulation phase interests before 1 July 2017.
2. Legislative references in this draft Guideline include those to legislation as proposed to be amended by Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 (the Bill).

Context of the transitional CGT relief for funds

3. To prepare for the transfer balance cap reforms commencing on 1 July 2017, individuals may need to reduce amounts currently supporting superannuation income streams to comply with the new requirements. They might do this by withdrawing amounts from the superannuation environment (that is, by partially or fully commuting their superannuation interests)¹, or by transferring value from the retirement phase to the accumulation phase. Action may also be required because a transition-to-retirement income stream (TRIS) will not be a superannuation income stream in retirement phase from 1 July 2017.² Hence, a fund will lose the exemption for assets supporting TRISs from this time.
4. Action members take in anticipation of the reforms could result in the capital value of a superannuation income stream interest being reduced. Consequently, superannuation funds using the segregated method may need to reallocate CGT assets they hold from their segregated current pension asset pool.³ Alternatively, the proportion used to calculate the exempt income of funds using the proportionate method will be adjusted.
5. The CGT relief provisions preserve the income tax exemption for capital gains accrued, but not yet realised, by a complying superannuation fund on CGT assets held throughout the pre-commencement period (see below). Relief is provided because a

¹ The Commissioner's view is that a member (or a dependant beneficiary) 'commutes' a superannuation income stream if they consciously and validly exercise their right to exchange some or all of their entitlement to receive future superannuation income stream benefits for an entitlement to be paid a lump sum (Taxation Ruling TR 2013/5 *Income tax: when a superannuation income stream commences and ceases*, at paragraph 110).

² Section 307-75 and paragraph 307-80(3)(a) of the *Income Tax Assessment Act 1997* (ITAA 1997).

³ The segregated current pension asset pool supports superannuation income streams (subsections 295-385(3) and 295-385(4) of the ITAA 1997). The segregated non-current asset pool supports accumulation interests (subsection 295-395(2)). Assets in excess of the value of certain superannuation income stream benefits are prevented from being segregated current pension assets (subsection 295-385(6)).

member reduces the value of their superannuation income stream before 1 July 2017, to comply with the transfer balance cap or TRIS reforms commencing. The effect of the exempt current pension income provisions is preserved for the entire value of superannuation income stream interests, until:

- (i) immediately before the time an asset ceased being a segregated current pension asset during the pre-commencement period, or
- (ii) 30 June 2017, where the proportionate method is used.

6. The relevant law will be contained in sections 294-100 to 294-120 of the *Income Tax (Transitional Provisions) Act 1997* (ITTPA 1997) (the CGT relief provisions). The relief is not available for a life insurance company because comparable relief is already available under Division 320 of the ITAA 1997.

7. The relief only applies to certain CGT assets held by a fund throughout the 'pre-commencement period'. The pre-commencement period is the period starting on the start of the day the Bill implementing the transfer balance cap and TRIS changes was tabled in the House of Representatives⁴, to just before 1 July 2017.

8. The CGT relief provisions do not need to apply to capital gains realised on the actual disposal, during the pre-commencement period, of CGT assets used to support superannuation income streams.⁵ For example, such assets might be realised to support a partial commutation of a superannuation income stream benefit. The realised assets may or may not support value transfers because of the reforms commencing. Relief is not required in this case because gains on such assets would already be exempt to the extent that current exemption rules apply.⁶

Object of the CGT relief provisions

9. The object of the CGT relief provisions is to provide temporary relief from certain capital gains that might arise as a result of individuals complying with the transfer balance cap or TRIS reforms commencing.⁷ The use of the term 'as a result of' in the object clause indicates that there must be a connection between the actions an individual took to comply with the reforms, and any capital gain arising on assets used to support the relevant superannuation income stream.

10. When interpreting the CGT relief provisions, an interpretation that best achieves this object is to be preferred.⁸ In a self-assessment environment, this means that the onus is on a fund's trustee to ensure that any of the following choices it makes is consistent with this object:

- (i) the choice to reset the cost base of a CGT asset to its market value, when the asset ceases being a segregated current pension asset during the pre-commencement period, but is held by the fund throughout that period⁹
- (ii) the choice to reset the cost base for an unsegregated CGT asset to its market value on 30 June 2017, where the fund holds the asset throughout the pre-commencement period¹⁰, and

⁴ The measure is contained in Schedule 1, Part 3 of the Bill. It was introduced into the House of Representatives on 9 November 2016. If this Bill is enacted containing the CGT relief provisions, the start of the pre-commencement period will be the start of 9 November 2016.

⁵ This is the effect of paragraphs 294-110(1)(c) and 294-115(1)(c) of the ITTPA 1997, which requires an asset to have been held throughout the pre-commencement period for the CGT relief provisions to apply.

⁶ The exemption rules are in Subdivision 295-F of the ITAA 1997, as it applied before 1 July 2017.

⁷ Section 294-100 of the ITTPA 1997.

⁸ Section 15AA of the *Acts Interpretation Act 1901* (Cth).

⁹ Paragraph 294-110(1)(e) of the ITTPA 1997.

¹⁰ Paragraph 294-115(1)(e) of the ITTPA 1997.

- (iii) the choice to defer recognising a capital gain that arises once the cost base is reset under (ii) above.¹¹

11. The mechanism used to reset the cost base of a CGT asset to its market value is to deem a sale, followed by an immediate repurchase of the asset. The deeming only applies for the purposes of the CGT provisions in Parts 3-1 and 3-3 of the ITAA 1997 (the CGT regime). This leads to a capital gain or loss arising at the time of the deemed sale. That gain or loss is entirely disregarded for segregated current pension assets. Capital gains are partly disregarded for unsegregated assets under the proportionate method, and may be deferred. Capital losses on unsegregated assets are recognised in accordance with current rules.¹²

12. It is reasonably likely that choices made by a fund's trustee to maximise relief under the provisions are related to the transfer balance cap or TRIS reforms commencing, provided member transfers are made at arm's length by a fund's trustee.¹³ To establish that CGT relief is exercised consistent with the object, the fund's trustee may wish to revise the information they have available.

Making a valid choice and keeping records

13. CGT relief is not automatic. The trustee of a complying superannuation fund must choose for the relief to apply for a CGT asset in the approved form.¹⁴

14. The choice is irrevocable, and must be made before a trustee is required to lodge their fund's 2016–17 income tax return.¹⁵

15. A choice in the approved form is only a valid choice if it is consistent with the object of the CGT relief provisions (see paragraphs 9 to 12 of this draft Guideline). By signing the relevant declaration in the approved form¹⁶, a trustee is declaring that they are making a valid choice.

16. The choice is made on an asset-by-asset basis.¹⁷ It is not made on an asset-class basis (for example, a fund's defensive asset class).

17. A fund will need to keep appropriate records for the assets subject to CGT relief, and the exempt portion of any deferred capital gain, in accordance with the record keeping requirements in the CGT regime.¹⁸ Records need to be maintained to ensure that capital gains or losses on the subsequent realisation of these assets can be accurately determined.

¹¹ Paragraph 294-120(1)(c) of the ITTPA 1997.

¹² That is, a current-year capital loss is recognised at Step 1 of the method statement in section 102-5 of the ITAA 1997. If there is a net capital gain remaining at Step 5, that amount is reduced for the section 295-390(3) of the ITAA 1997 exempt proportion for the income year, to determine the assessable amount. Any net capital loss at Step 5 is not proportioned before it is carried forward.

¹³ Explanatory Memorandum (EM) to the Bill, at paragraph 3.331.

¹⁴ At the time of issue of this draft Guideline, the approved form was not yet available. So, it is not yet apparent if the manner in which a fund completes its 2016–17 income tax return will be accepted as the approved form, or whether a separate document will need to be completed.

¹⁵ Subsections 294-110(2), 294-115(2) and 294-120(2) of the ITTPA 1997.

¹⁶ Sections 388-50(1)(b) and 388-75 in Schedule 1 of the *Taxation Administration Act 1953*.

¹⁷ Refer to Taxation Determination TD 33 *Capital Gains: How do you identify individual shares within a holding of identical shares?* for guidance on how individual shares within a holding of identical shares may be identified.

¹⁸ Sections 121-20 and 121-25 of the ITAA 1997. Also refer to paragraphs 3.362 to 3.364 of the EM to the Bill.

Which assets does CGT relief apply to?

18. The CGT assets eligible for relief depends on whether the fund, during the pre-commencement period: uses the segregated method¹⁹, starts using the proportionate method, or continues using the proportionate method.²⁰

Fund uses the segregated method

19. A fund using the segregated method classifies its CGT assets as either segregated current pension assets, or segregated non-current assets. Assessable income derived from segregated current pension assets is income tax exempt, while income derived from segregated non-current assets is generally assessable.

20. An asset, commonly, stops being a segregated current pension asset when a segregated fund ceases holding the asset 'solely' to meet liabilities it has regarding superannuation income stream benefits payable at that time.²¹

21. A precursor to a trustee choosing CGT relief is that a member will have to transfer value back to the accumulation phase to comply with the transfer balance cap or TRIS reforms commencing.²² This sets the context for accessing relief. An asset of a segregated fund that supports value being transferred by a member back to the accumulation phase will be reclassified as a segregated non-current asset. CGT relief is available for such a CGT asset provided:²³

- the asset was a segregated current pension asset at the start of the pre-commencement period, but stopped being such an asset at a time (the 'cessation time') during that period
- the fund held the asset throughout the pre-commencement period (disregarding the deemed sale and repurchase of the asset by the fund because relief applies)
- the fund is a complying superannuation fund from the start of the pre-commencement period, to the time the asset stopped being a segregated current pension asset, and
- the trustee chooses for relief to apply to the asset (in the manner discussed in paragraphs 13 -17 of this draft Guideline).

22. If the context and conditions described in the previous paragraph are satisfied, a fund may choose relief for a CGT asset that supports value transferred by a member to the accumulation phase because of the transfer balance cap or TRIS reforms commencing. Doing so is consistent with the object of the CGT relief provisions.

23. Sometimes, a member of a segregated fund may need to transfer value back to the accumulation phase that is greater than the expected excess in their transfer balance account on 1 July 2017. This might be necessary where, for example, the market value of the asset supporting value to be transferred, is greater than the member's expected excess, and the fund wants to remain segregated.²⁴ In these circumstances, a trustee can choose to apply CGT relief for assets that are reallocated to support the increased value of the member's accumulation phase interest.

24. In other words, it is not a condition for a segregated fund to access CGT relief, for total member transfers made in anticipation of the transfer balance cap start date, to be

¹⁹ Sections 295-385 and 295-395 of the ITAA 1997.

²⁰ Section 295-390 of the ITAA 1997.

²¹ Subsections 295-385(3) and 295-385(4) of the ITAA 1997.

²² This is apparent from the objects clause in section 294-100 of the ITTPA 1997.

²³ Sections 294-110(1) and 294-110(2) of the ITTPA 1997.

²⁴ If the member did not transfer value equivalent to the market value of the asset, back to the accumulation phase, the fund would need to start using the proportionate method (see below).

equal in value to the expected excess in a member's transfer balance account on 1 July 2017. The law also does not require the total deemed capital gains calculated under the CGT relief provisions to equal the sum of the expected excesses in all members' transfer balance accounts on 1 July 2017.

Certain SMSFs and small-APRA funds may not be segregated

25. A fund is excluded from using the segregated method from the 2017–18 income year if, for an income year:²⁵

- the fund is either an SMSF, or has less than 5 members, at any time during the year
- at least one member has a retirement phase interest in the fund at any time during the year, and
- all of the following apply:
 - a member has a 'total superannuation balance' exceeding \$1.6m just before the start of the year
 - the same member is a recipient of retirement phase benefits payable just before the start of the year (whether from the fund or another provider), and
 - the same member has a superannuation interest in the fund at any time during the year.

26. A member's 'total superannuation balance' includes their accumulation and retirement-phase interests, and certain rollovers.²⁶ It is not limited to interests in the retirement phase that are subject to the transfer balance cap and TRIS changes.

27. This means that an SMSF, or small-APRA fund, could have a member with a transfer balance account balance under the \$1.6m cap from 1 July 2017, but who also has a total superannuation balance exceeding \$1.6m. If so, the fund could not be segregated from the 2017–18 year while this situation continued. However, such funds can still choose CGT relief using the segregated method for the 2016–17 year, provided the eligibility requirements in paragraph 21 of this draft Guideline are satisfied.

Fund starts using the proportionate method

28. A fund that was using the segregated method might not be able to reclassify an asset as a segregated non-current asset to support value transferred to the accumulation phase, and so would need to start using the proportionate method.

29. This could arise, for example, where a fund has a single asset supporting retirement-phase liabilities that must, because of a transfer made to reduce a member's expected transfer balance account excess on 1 July 2017, also support an accumulation phase interest.²⁷ It could also arise if a member of a segregated fund transferred value to the accumulation phase, which was less than the market value of the asset required to support the transfer.

30. Assets will cease being segregated current pension assets in the pre-commencement period, when the fund gives effect to value transferred by a member

²⁵ The fund's assets will be treated as 'disregarded small fund assets', which are deemed not to be segregated current pension assets. Refer to section 295-385(7) and 295-387 of the ITAA 1997.

²⁶ Section 307-320 of the ITAA 1997.

²⁷ As the asset is not being dealt with for the sole purpose of enabling the fund to discharge all or part of its liabilities in respect of superannuation income stream benefits, it cannot be a segregated current pension asset under subsection 295-385(3) of the ITAA 1997.

during that period, which results in the fund starting to have assets that support both accumulation and retirement phase interests. This will be the cessation time.

31. A fund can choose CGT relief for some, or all, of the assets that stop being segregated current pension assets, provided the context and conditions in paragraph 21 of this draft Guideline are satisfied.²⁸ The context includes that the fund must start having to use the proportionate method in the 2016–17 income year as a result of members complying with the transfer balance cap or TRIS reforms commencing.²⁹ This allows a fund to preserve the income tax exemption on capital gains accrued until the cessation time.

32. A fund might require an actuary's certificate to support its use of the proportionate method³⁰, which would be a new compliance obligation for funds that previously only had segregated current pension assets under subsection 295-385(4) of the ITAA 1997. However, a regulation is expected to be made so that certain superannuation funds will not be required to obtain an actuary's certificate in calculating their exempt income for an income year.³¹

Example

33. *Sue and Ben are both 67 and are the only members of their SMSF. They are both retired and do not meet the work test. The SMSF's assets are segregated current pension assets given its members are only receiving account-based pensions.*

34. *On 1 July 2017, Ben expects to have a transfer balance account balance of \$1.8m and Sue a transfer balance account balance of \$600,000. The SMSF has three assets supporting Sue and Ben's pensions, each with a market value of \$800,000 that are owned by the SMSF throughout the pre-commencement period.*

35. *Ben transfers \$200,000 to the accumulation phase in anticipation of the transfer balance cap start date. The trustee considers it undesirable to sell any of the SMSF's assets. None of the SMSF's assets can be classified as a segregated non-current asset to support the transfer. Therefore, to give effect to the transfer and to maximise the exemption period, the SMSF starts using the proportionate method on 30 June 2017.*

36. *In this example, the SMSF starts using the proportionate method in the 2016–17 year as a result of Ben complying with the start of the transfer balance cap reforms. The trustee may choose CGT relief for any, or all, of its CGT assets, because they all stopped being segregated current pension assets on 30 June 2017. There is no evidence that the fund has contrived circumstances to access the relief.*

37. *The relief is still available, even though the fund will, nonetheless, have to use the proportionate method from the 2017–18 year. This is because Ben has a total superannuation balance exceeding \$1.6m on 30 June 2017, and the other conditions referred to in paragraph 25 of this draft Guideline are satisfied.*

Fund continues using the proportionate method

38. A precursor to a trustee choosing CGT relief is that a member will have to transfer value back to the accumulation phase to comply with the transfer balance cap or TRIS

²⁸ The relief that applies is for segregated current pension assets in section 294-110 of the ITTPA 1997. This is because the assets of a fund that starts having to use the proportionate method during the pre-commencement period, would not be unsegregated assets throughout that period (paragraph 294-115(1)(d) of the ITTPA 1997).

²⁹ Section 294-100 of the ITTPA 1997.

³⁰ Subsections 295-390(4) and 295-395(5) of the ITAA 1997.

³¹ The proposed regulation (under subsection 295-390(7) of the ITAA 1997) will apply to funds that only have liabilities in respect of retirement income stream benefits arising from account-based, superannuation income stream products (EM to the Bill, at paragraph 3.337).

reforms commencing.³² This sets the context for accessing relief. If a fund is using, and continues to use, the proportionate method throughout the pre-commencement period, it may choose relief for a CGT asset provided:³³

- the fund is a complying superannuation fund throughout the pre-commencement period, and held the asset throughout that period
- for the 2016–17 income year, the average value of the fund's current pension liabilities, divided by the average value of its superannuation liabilities, exceeds nil (that is, the proportion in subsection 295-390(3) of the ITAA 1997 exceeds nil)
- the asset was not a segregated current pension asset or a segregated non-current asset throughout the pre-commencement period, and
- the trustee chooses for relief to apply to the asset (in the manner discussed in paragraphs 13 to 17 of this draft Guideline).

39. The law does not expressly restrict CGT relief under the proportionate method to those assets having a total market value on 30 June 2017 equal to the sum of the expected excesses in members' transfer balance accounts on 1 July 2017. Nor is relief restricted to the total amounts members' transferred back to the accumulation phase in anticipation of the transfer balance cap or TRIS reforms commencing.

40. However, a large difference between the expected excesses in members' transfer balance accounts on 1 July 2017 and the gains sheltered by the CGT relief might indicate that a trustee has applied the CGT relief for reasons other than a member complying with the transfer balance cap or TRIS reforms commencing.

Application of the general anti-avoidance provisions

41. As already noted, the object of the CGT relief provisions is to support asset reallocations or reapportionments in complying superannuation funds because members need to comply with the transfer balance cap or TRIS reforms commencing.

42. Broadly speaking, schemes which do no more than that which is necessary to comply with those reforms will not be the subject of determinations under Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936) (Part IVA). Schemes which abuse the relief are another matter.

43. Part IVA applies to a scheme if a tax benefit has been obtained in connection with the scheme and the main purpose of a person who participated in the scheme, or a part of it, was to enable a taxpayer to obtain that tax benefit.³⁴ The non-inclusion of an amount in a taxpayer's assessable income for an income year that, apart from the scheme, would or might reasonably be expected to be, included in their assessable income is a tax benefit.³⁵

44. However, where the non-inclusion of an amount in a taxpayer's assessable income is attributable to the making of an election or choice expressly provided by the income tax law, no tax benefit is obtained by the taxpayer, unless the scheme put the taxpayer in the position to make that election and a person who participated in the scheme did so with that purpose.³⁶ Practically speaking, there is little or no difference between the purpose of obtaining a tax benefit and enabling oneself to make an election, since the point of making the election will be to enjoy the tax result which follows. Merely making the election, however, without having done anything to enable that to take place, cannot result in the taxpayer obtaining a tax benefit.

³² This is apparent from the object clause in section 294-100 of the ITTPA 1997.

³³ Subsections 294-115(1) and 294-115(2) of the ITTPA 1997.

³⁴ Section 177D of the ITAA 1936.

³⁵ Section 177C(1)(a) of the ITAA 1936.

³⁶ Paragraph 177C(2)(a) of the ITAA 1936.

45. Accordingly, Part IVA will apply to schemes entered into or carried out for the purpose of enabling a taxpayer to make an election under paragraphs 294-110(1)(e) or 294-115(1)(e) of the ITTPA 1997, with a view to obtaining the resulting tax benefit.³⁷

46. The kinds of arrangements that the Commissioner will scrutinise carefully with a view to determining whether Part IVA applies will exhibit the following features:

- (i) they place the taxpayer in a position to make the choice
- (ii) they go further than is necessary to provide temporary relief from CGT because members comply with the reforms, and
- (iii) they exhibit contrivance of manner, a lack of correspondence of form with substance, or other matters relevant under section 177D of the ITAA 1936, that point to the purpose of avoiding tax.

47. In relation to segregated funds, two of the main requirements for making the choice are to have an existing segregated current pension asset pool, and to cause an existing segregated current pension asset to cease being one in the pre-commencement period. A scheme of concern involves causing an asset (with large unrealised capital gains) to form part of a fund's segregated current pension asset pool before the pre-commencement period, and then causing it to revert to accumulation phase during the pre-commencement period by making the choice; the question will then be the purposes for which these steps were undertaken. It would be appropriate to infer that this scheme was carried out, firstly to enable the taxpayer to make the choice, and then to obtain a tax benefit in the form of omitted assessable income. Part IVA would then apply to the scheme.

48. This scheme is a species of so-called asset washing schemes.³⁸ Taxation Ruling TR 2008/1 *Income tax: application of Part IVA of the Income Tax Assessment Act 1936 to 'wash sale' arrangements* explains how Part IVA can apply to other kinds of wash sale schemes. In the schemes described by TR 2008/1, there is generally no change in the economic position of the taxpayer, apart from tax, that results from the scheme. This leaves the purpose of obtaining the tax benefit as the prevailing or only purpose of the participants in the scheme. Similarly, here, there will be little or no change in the economic position of the fund, apart from tax, resulting from the scheme. Once it is seen that a scheme goes further than is necessary to comply with the transfer balance cap or TRIS reforms commencing, because the scheme involves additional steps unnecessary for that purpose but necessary to obtain the tax benefit via the choice, it will generally follow that the proper inference is that the participants entered into and carried out the scheme to obtain a tax benefit through having put themselves in the position to make the choice.

49. There may be other ways in which the relief provided by these changes could be abused. Further guidance will be issued in respect of these as required.

Effect of the deemed sale and repurchase

50. If CGT relief is chosen, there is a deemed sale by the fund of the relevant CGT asset for market value consideration. The sale occurs:

- (i) immediately before the cessation time (refer to paragraph 21 of this draft Guideline) for an asset that ceased being a segregated current pension asset in the pre-commencement period, or
- (ii) on 30 June 2017 if the fund uses the proportionate method.³⁹

³⁷ An election referred to in Part IVA includes a choice under either of these provisions.

³⁸ EM to the Bill, at paragraph 3.330.

³⁹ Paragraphs 294-110(3)(a) and 294-115(3)(a) of the ITTPA 1997.

51. It is legally impossible for an entity to sell an asset to itself. Inherent in the ordinary meaning of a 'sale' is the transfer of property, usually for money or credit.⁴⁰ So, for a 'sale' to exist, a fund must be treated as having transferred the CGT asset to another entity.

52. The sale is also treated as being 'for' market value 'consideration', so value is deemed to be provided by another entity in connection with the sale.

53. The effect of the deemed sale is that the fund ceases, for an instant in time, being the owner of the asset for the purposes of the CGT regime. This means that the fund is deemed to have disposed of the relevant CGT asset at the applicable sale time, and CGT event A1 will be triggered.⁴¹

54. The fund is deemed to have purchased the asset again for market value consideration. The time of the repurchase is:

- (i) at the cessation time, for an asset that ceased being a segregated current pension asset in the pre-commencement period, or
- (ii) 1 July 2017 where the fund uses the proportionate method.⁴²

55. It is also legally impossible for an entity to purchase an asset from itself. The deemed repurchase will involve a change in ownership of the relevant CGT asset from the other entity back to the fund at the repurchase time.

56. The repurchase is also treated as being 'for' market value 'consideration', so the fund is taken to have provided value to the other entity in connection with the purchase to support the reacquisition.

Effect of deeming on the CGT discount period

57. The deemed repurchase results in the fund becoming the owner of the asset 'again' at the repurchase time, for the purposes of the CGT regime.⁴³ To qualify for the CGT discount on the eventual realisation of the asset, a fund will need to have owned the asset for at least 12 months starting from the deemed repurchase time.⁴⁴

Deeming cannot be 'unwound'

58. The future financial performance of an asset will influence a fund's decision to choose CGT relief. Obviously, gauging the future performance of an asset is an inexact science and is acknowledged as one of the intentional, but practical difficulties, in deciding whether to apply the provisions to an asset.

59. An effect of a valid choice for relief being irrevocable⁴⁵ is that the deemed sale and repurchase of an asset cannot be reversed. This is especially relevant for funds where an asset's future performance turns out to be unexpectedly, unfavourable. A fund may not have chosen 'relief' had that outcome been known when the choice was made. The law does not provide a mechanism to 'unwind' relief in this situation.

Effect of resetting an asset's cost base to its market value

60. The provisions provide relief from certain capital gains arising because of asset reallocations or reapportionments during the pre-commencement period. Although the relief operates for certain CGT assets held by a fund throughout this transitional period, if

⁴⁰ *Macquarie Dictionary & Thesaurus Online* (6th edition), 2013.

⁴¹ Section 104-10 of the ITAA 1997, and the EM to the Bill at paragraph 3.324.

⁴² Paragraphs 294-110(3)(b) and 294-115(3)(b) of the ITTPA 1997.

⁴³ Subsections 109-5(1) and 109-5(2) of the ITAA 1997.

⁴⁴ Section 115-25 of the ITAA 1997.

⁴⁵ Paragraphs 294-110(2)(c), 294-115(2)(c) and 294-120(2)(c) of the ITTPA 1997.

chosen, the relief results in a permanent modification to an asset's cost base/reduced cost base.⁴⁶

61. Choosing the relief might sometimes result in a capital loss arising on the deemed sale of a CGT asset, as the asset's market value at that time may be less than its reduced cost base. Trustees may not be inclined to choose relief for assets with unrealised capital losses⁴⁷, but it is conceivable that in some situations they might.

62. A deemed capital loss may be utilised in the 2016–17 year under the proportionate method if the fund also has capital gains available, otherwise it is carried forward to a future income year.⁴⁸

63. Also, a capital loss on the actual realisation of an asset that is subject to relief, can only arise in the 2017–18 income year, or a following year, as a result of its reduced cost base being reset. This is because the asset needs to be held throughout the pre-commencement period to qualify for a step up in its reduced cost base.⁴⁹

Deemed sale and repurchase only relevant for CGT purposes

64. The market value of a CGT asset on a deemed sale and reacquisition under the CGT relief provisions is determined exclusive of GST.⁵⁰ This is because the deeming only applies for the purposes of the CGT regime;⁵¹ it does not apply for GST purposes to deem a supply to have been made. So, any deemed sale could not be a GST taxable supply.

65. Likewise, the deemed sale and re-acquisition for CGT purposes does not affect a fund's capital allowance or capital works deductions, or the cost of its assets for such purposes.

Options available to a fund when considering CGT relief

66. The effect that choosing CGT relief has for a fund depends on whether an asset stops being a segregated current pension asset during the pre-commencement period, or whether the fund continues using the proportionate method in the 2016–17 income year.

67. As already noted, a fund might start having to use the proportionate method in the pre-commencement period because a member complies with the transfer balance cap or TRIS reforms commencing. In this situation, the fund can choose the relief that applies for assets that stop being segregated current pension assets.

Asset stops being a segregated current pension asset

68. If the context and conditions in paragraph 21 of this draft Guideline are satisfied, a fund has two options available for an asset that stops being a segregated current pension asset in the pre-commencement period.

Option one: fund chooses to apply CGT relief⁵²

69. The fund can choose for CGT relief to apply.

⁴⁶ Paragraphs 294-110(3)(b) and 294-115(3)(b) of the ITTPA 1997.

⁴⁷ For example, where the capital loss is disregarded because it relates to the deemed disposal of a segregated current pension asset (under section 118-320 of the ITAA 1997).

⁴⁸ Sections 102-5 to 102-15 of the ITAA 1997.

⁴⁹ Paragraphs 294-110(1)(c) and 294-115(1)(c) of the ITTPA 1997.

⁵⁰ Section 960-405 of the ITAA 1997 also supports this conclusion.

⁵¹ Subsections 294-110(3) and 294-115(3) of the ITTPA 1997.

⁵² Refer to Example 3.60 in the EM to the Bill for additional practical guidance.

70. This results in a deemed sale of the asset for its market value immediately before the time (cessation time) the asset stopped being a segregated current pension asset. CGT event A1 happens as a result of the deemed sale at the time of the sale.

71. Any capital gain or loss resulting from the deemed sale is disregarded for the 2016–17 income year.⁵³

72. The fund is deemed to have repurchased the asset at the cessation time. This means that the acquisition date of the asset, and hence the start of the CGT discount period, is reset to the day of the cessation time. Another effect of resetting the acquisition date is that the indexation method is no longer available when calculating capital gains on assets originally acquired before 11.45am Eastern time on 21 September 1999.

73. The asset's cost base/reduced cost base is reset, with its first element becoming the asset's market value at the deemed repurchase time.

74. Relief may have been chosen because the asset was allocated to the fund's segregated non-current asset pool. When a CGT event subsequently happens to such an asset, only the capital gain or loss accrued on the asset from the cessation time to the event time is recognised at Step 1 of the method statement in section 102-5 of the ITAA 1997 (method statement). Any net capital gain remaining at Step 5 will be assessable income for the CGT event year, and a net capital loss is carried forward.

75. Alternatively, relief may have been chosen because the fund started having to use the proportionate method in the pre-commencement period. When a CGT event subsequently happens to the asset, the capital gain or loss accrued on the asset from the cessation time to the event time is also recognised at Step 1 of the method statement. But, if there is a net capital gain remaining at Step 5, that amount is reduced for the exempt proportion (in subsection 295-390(3) of the ITAA 1997⁵⁴) for the CGT event year, to determine the assessable amount. There is no provision in the law for a net capital loss of a fund using the proportionate method at Step 5, to be proportioned before it is carried forward.

Option two: fund chooses not to apply CGT relief

76. The fund may choose not to apply the CGT relief provisions when the asset stops being a segregated current pension asset.

77. In this case, there is no deemed sale and reacquisition of the asset. The CGT asset's original cost base and acquisition time are preserved. Any capital gain or capital loss is determined under existing rules when a CGT event subsequently happens to the asset.

78. If the asset was allocated to the segregated non-current asset pool (and remained there), the entire capital gain or capital loss accrued on the asset from when it was originally acquired to the CGT event time is recognised at Step 1 of the method statement. Any net capital gain remaining at Step 5 will be assessable income for the CGT event year, and a net capital loss is carried forward.

79. If the fund starts having to use the proportionate method in the pre-commencement period, the only difference from the previous paragraph is that the Step 5 amount is reduced for the s 295-390(3) exempt proportion to determine the assessable amount for the CGT event year. Any net capital loss is not proportioned at Step 5 before it is carried forward.

⁵³ Section 118-320 of the ITAA 1997.

⁵⁴ The exempt proportion in subsection 295-390(3) of the ITAA 1997 for an income year is the: average value of a fund's current pension liabilities for the year, divided by the average value of its superannuation liabilities for the year.

Fund continues using the proportionate method

80. A fund that uses the proportionate method throughout the pre-commencement period has three options available for relief. To qualify, the fund must satisfy the context and conditions in paragraph 31 of this draft Guideline.

Option one: fund chooses to apply CGT relief, but chooses not to defer any capital gain⁵⁵

81. A fund could choose to apply CGT relief and to recognise any capital gain or loss in the 2016–17 income year.

82. This results in a deemed sale of the asset for its market value on 30 June 2017, and CGT event A1 happens at that time. Any capital gain or loss is recognised at Step 1 of the method statement. If there is a net capital gain remaining at Step 5, that amount is reduced for the subsection 295-390(3) exempt proportion for the 2016–17 income year, to determine the assessable amount. Any net capital loss at Step 5 is not proportioned before it is carried forward.

83. The fund is deemed to have repurchased the asset on 1 July 2017. This means that the acquisition date of the asset, and hence the start of the CGT discount period, is reset to 1 July 2017. Another effect of resetting the acquisition date is that the indexation method is no longer available when calculating capital gains on assets originally acquired before 11.45am Eastern time on 21 September 1999.

84. The asset's cost base/reduced cost base is reset, with its first element becoming the asset's market value on 1 July 2017.

85. When a CGT event subsequently happens to the asset, the capital gain or loss accrued on the asset from 1 July 2017 to the event time is also recognised at Step 1 of the method statement, with any net capital gain remaining at Step 5 reduced for the subsection 295-390(3) exempt proportion for the CGT event year. Any net capital loss at Step 5 is not proportioned before it is carried forward.

Option two: fund chooses to apply CGT relief, and chooses to defer a capital gain⁵⁶

86. A fund could choose to apply CGT relief and also choose to defer recognising a capital gain until the income year the asset is realised.

87. A capital loss on the deemed sale of the asset cannot be deferred.

88. Choosing this option results in a deemed sale of the asset for its market value on 30 June 2017, and CGT event A1 happens at this time.

89. The capital gain from the deemed sale will be the asset's market value on 30 June 2017, less the asset's cost base. The amount that is deferred is discussed at paragraphs 91 to 97 of this draft Guideline.

90. Similar to option one immediately above, the fund is deemed to have repurchased the asset on 1 July 2017 for its market value. The acquisition date and CGT discount period, along with the asset's cost base are reset. The indexation method will no longer be available for assets originally acquired before the 21 September 1999 time.

Calculating the deferred capital gain

91. To calculate the deferred capital gain, the fund applies the method statement for the 2016–17 income year with adjustments. The adjustments ensure that any CGT discount available for the asset up to 30 June 2017 is recognised.⁵⁷

⁵⁵ Refer to Example 3.61 in the EM to the Bill for additional practical guidance.

⁵⁶ Refer to Examples 3.62 to 3.64 in the EM to the Bill for additional practical guidance.

92. Calculating the deferred gain requires the fund to initially hypothesise that the capital gain on the deemed sale is not going to be deferred.
93. The fund also assumes that the deferred gain is its only capital gain for the 2016–17 year. The capital gain on the deemed sale is recognised, hypothetically, at Step 1 of the method statement.
94. The fund further assumes it has no current year capital losses at Step 1 of the method statement, or any prior year capital losses at Step 2.
95. The CGT discount is applied at Step 3 of the method statement, provided the fund acquired the asset before 1 July 2016.
96. The fund reduces the net capital gain remaining at Step 5 of the method statement, for the subsection 295-390(3) exempt proportion for the 2016–17 income year.
97. The resulting amount from this hypothetical application of the method statement is the fund's deferred capital gain on the asset for the 2016–17 year.

Recognising the deferred capital gain

98. A deferred capital gain is recognised for the income year in which a 'realisation event'⁵⁸ happens to the asset. The realisation event must happen in the 2017–18 income year or a subsequent year.
99. A 'realisation event' is a subset of the CGT events listed in section 104-5 of the ITAA 1997. It involves those CGT events that result in a fund ceasing to own the relevant CGT asset. Typically, a fund will realise an asset by selling it to another entity, which will trigger CGT event A1 at the relevant disposal time. It is, of course, conceivable for other CGT events to apply. For example, CGT event C1 would apply if the asset was realised because it was lost or destroyed. CGT event E2 would apply if the fund realised the asset by transferring it to another trust.
100. The capital gain or loss accrued on the asset from 1 July 2017 until the realisation event time, is recognised at Step 1 of the method statement for the realisation year. This capital gain may be a discount capital gain and reduced at Step 3, provided the asset is realised after 30 June 2018 (noting that the asset is deemed to have been (re)acquired by the fund on 1 July 2017).
101. The fund should add the deferred capital gain on assets from the 2016/17 year at Step 1 for the realisation year, but that amount is not a discount capital gain when applying the Method Statement for the realisation year.⁵⁹
102. The fund reduces the net capital gain remaining at Step 5 of the method statement, for the subsection 295-390(3) exempt proportion for the realisation year. However, the fund cannot reduce the Step 5 net capital gain to the extent that a net capital gain is increased, or is created, because the deferred capital gain was recognised for the year.⁶⁰

Option three: fund chooses not to apply CGT relief⁶¹

103. A fund using the proportionate method may choose not to apply the CGT relief provisions for a qualifying asset it has held throughout the pre-commencement period.
104. In this case, there is no deemed sale and reacquisition of the asset. The CGT asset's original cost base and acquisition time are preserved. Any capital gain or capital

⁵⁷ Refer to subsections 294-120 (4) and 294-120(7) of the ITTPA 1997.

⁵⁸ Subsection 294-120(5) of the ITTPA 1997.

⁵⁹ Paragraph 294-120(5)(c) of the ITTPA 1997.

⁶⁰ Subsection 294-120(6) of the ITTPA 1997.

⁶¹ Refer to Example 3.65 in the EM to the Bill for additional practical guidance.

loss is determined under existing rules when a CGT event subsequently happens to the asset.

105. When the asset is eventually realised, the entire capital gain or capital loss accrued on the asset from when it was originally acquired to the CGT event time is recognised at Step 1 of the method statement. Any net capital gain remaining at Step 5 will be reduced for the subsection 295-390(3) exempt proportion in the realisation year to determine the assessable amount for that year. Any net capital loss at Step 5 is not proportioned before it is carried forward.

Commissioner of Taxation

24 November 2016

Your comments

106. You are invited to comment on this draft Law Companion Guideline. Please forward your comments to the contact officer by the due date. In particular, we welcome comments on further interpretative issues that have not yet been raised in this draft Guideline.

Due date: 8 December 2016
Contact officer: Grahame Hager
Email address: SuperConsultation@ato.gov.au
Telephone: (02) 9374 8762

References

ATOlaw topic(s)	Superannuation ~~ Income tax - individuals (superannuation) ~~ Other
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