

1987-88

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TAXATION LAWS AMENDMENT BILL (NO.6) 1988
INCOME TAX RATES AMENDMENT BILL (NO.2) 1988
INCOME TAX (FUND CONTRIBUTIONS) BILL 1988
INCOME TAX AMENDMENT BILL (NO.2) 1988

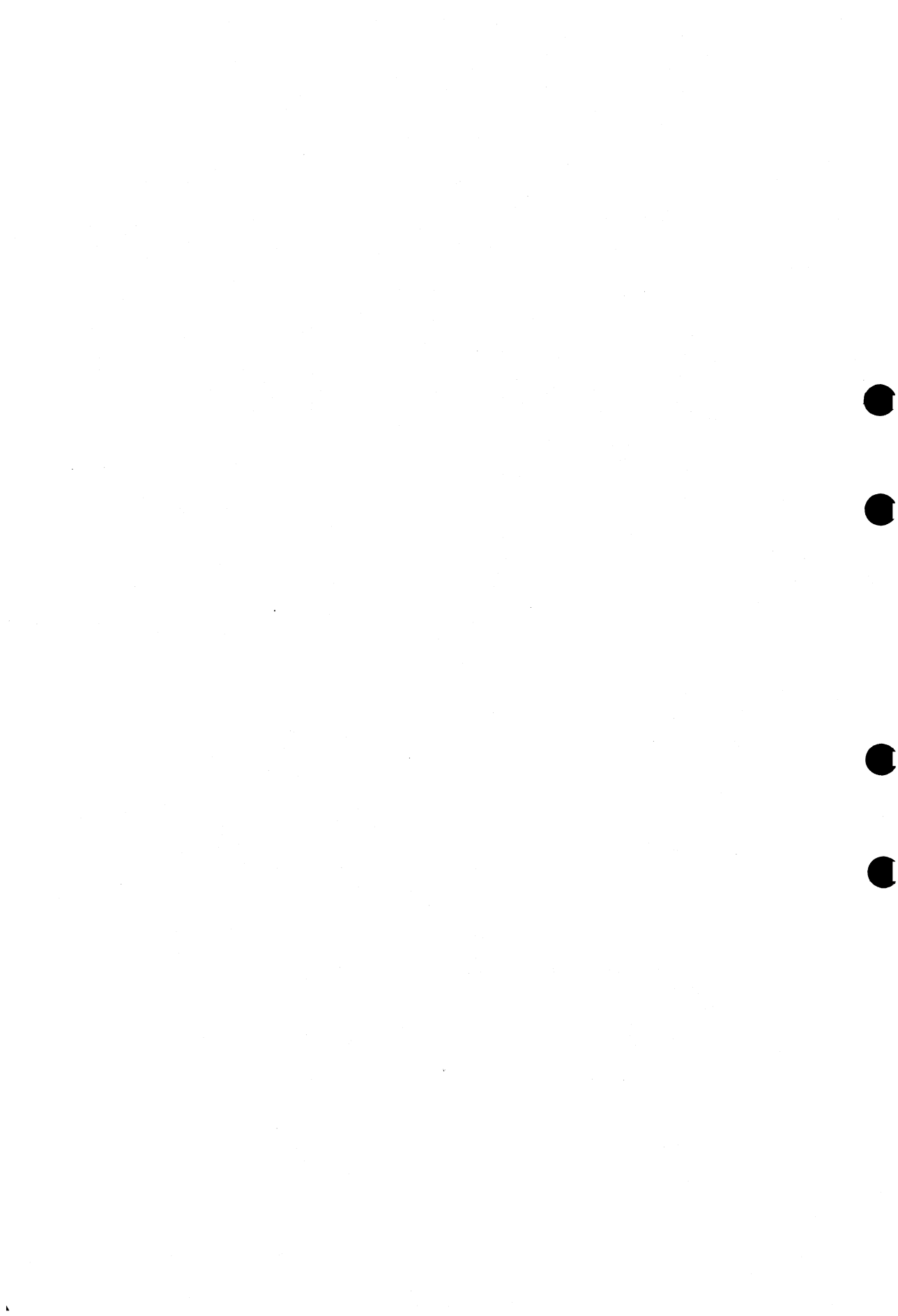
EXPLANATORY MEMORANDUM
PART A

(Circulated by authority of the Treasurer,
the Hon P.J. Keating, MP)

FOREWORD

Part A of this memorandum contains explanations that provide a broad guide to the measures contained in the four Bills.

Part B of the memorandum will contain a clause by clause explanation of the Bill.



GENERAL OUTLINE

TAXATION LAWS AMENDMENT BILL (NO.6) 1988

This Bill will amend the Income Tax Assessment Act 1936 -

Superannuation and Approved Deposit Funds

- . to introduce new arrangements for the taxation of superannuation funds and approved deposit funds, effective from 1 July 1988 (proposal announced in the Economic Statement of 25 May 1988 and in further statements dated 20 June 1988, 29 June 1988, 1 July 1988 and 11 August 1988);
- . to apply those new arrangements generally to Commonwealth and other public sector superannuation funds;
- . as part of those arrangements, to provide for the establishment of pooled superannuation trusts to act as investment vehicles for complying superannuation and approved deposit funds and to provide a basis for taxing such trusts;
- . to make provision for complying superannuation and approved deposit funds to transfer their liability to tax on contributions and certain rolled-over amounts to a pooled superannuation trust, a life insurance office or a registered organisation which agrees to take on that liability;
- . to remove the limits on deductibility of superannuation contributions made by employers on behalf of employees;
- . to increase the deduction available for superannuation contributions made to personal funds by self-employed persons and employees without employer superannuation support from \$1500 to \$3000;
- . to deny, from the date of introduction, deductions to employers for amounts merely set apart for the purpose of providing superannuation benefits for employees and not actually paid to a superannuation fund; and
- . to make consequential amendments as a result of the above superannuation amendments to the Income Tax Assessment Act and to certain other Acts including the Occupational Superannuation Standards Act 1987 and the Superannuation Act 1976.

Life insurance companies

- . to repeal, with effect from the 1988-89 income year, the deduction under section 115 and the exemption under section 116 relating to the calculated liabilities of life insurance companies (proposal announced in the Economic Statement of 25 May 1988).

Share cancellations

- . to provide that where shares held by a subsidiary company in its holding company are cancelled (or redeemed) and the consideration received by the subsidiary company for the cancellation is less than the market value of the shares :
 - the income tax (including the capital gains tax) effects for the subsidiary company, as a consequence of the cancellation, are to be determined on the basis that the consideration received was equal to the market value of the shares; and
 - the income tax (including the capital gains tax) consequences for the holding company on the disposal of its interests in the subsidiary (eg. shares) are to be determined as if the subsidiary had received market value for the cancelled shares (proposal announced on 11 August 1988).

Approved research institutes

- . to amend the definition of "an approved research institute" in the Act to alter the list of approving authorities.

INCOME TAX RATES AMENDMENT BILL (NO.2) 1988

This Bill will amend the Income Tax Rates Act 1986 to impose tax on complying superannuation funds, approved deposit funds and pooled superannuation trusts at 15% on their income generally and 49% on their excessive non-arm's length income.

INCOME TAX (FUND CONTRIBUTIONS) BILL 1988

This Bill will only have effect if the proposed amendment of the Income Tax Act 1986 is required to be given effect to. In that case this Bill will impose tax on the contributions to superannuation funds and approved deposit funds.

INCOME TAX AMENDMENT BILL (NO.2) 1988

This Bill will amend the Income Tax Act 1986 to ensure that, if the proposal to tax both contributions to superannuation funds and approved deposit funds and the other income of those funds would be in breach of the Constitution, the Income Tax Act will only apply to tax that other income.

FINANCIAL IMPACTTAXATION LAWS AMENDMENT BILL (NO.6) 1988

As stated in the May 1988 Economic Statement the proposal to tax formerly exempt superannuation funds and approved deposit funds together with the proposal (also announced in the May 1988 Economic Statement and to be included in another Bill) to tax the superannuation and rollover deferred annuity business income of life insurance companies and registered organisations is expected to generate additional revenue of \$980 million in 1989-90 and \$1,400 million in 1990-91. The net revenue gain will be smaller though because of proposed reductions in the tax payable on retirement benefits and the increase in the ceiling for deductible contributions by the self-employed and unsupported employees.

The revenue gain from the change to life insurance business taxation is estimated at \$70 million in 1988-89, although this will be more than offset by the reduction in the tax rate applicable to such business as proposed in the Income Tax Rates Amendment Bill 1988.

The proposed amendment relating to share cancellation arrangements is of a safeguarding nature. Without the amendment very significant amounts of revenue would be at risk from the deductions, including for capital losses, that the arrangements would generate.

The change to the definition of an approved research institute will have no impact on revenue.

INCOME TAX RATES AMENDMENT BILL (NO 2) 1988INCOME TAX (FUND CONTRIBUTIONS) BILL 1988INCOME TAX AMENDMENT BILL (NO 2) 1988

These three Bills will formally impose the tax to be payable on the taxable contributions and other income of complying superannuation funds, approved deposit funds and pooled superannuation trusts. The proposals complement the amendments contained in the Taxation Laws Amendment Bill (No.6) 1988 which will make the abovementioned entities subject to tax. As already noted, these measures are expected to generate additional revenue of \$980 million in 1989-90 and \$1,400 million in 1990-91.

MAIN FEATURES

The main features of these Bills are as follows :

TAXATION LAWS AMENDMENT BILL (No.6) 1988Amendment of the Income Tax Assessment Act 1936Taxation of superannuation fund income

(Clauses 9 and 10 and Schedule 1)

This Bill will give effect to the proposal, announced in the May 1988 Economic Statement, to tax the income of formerly tax exempt superannuation funds and approved deposit funds (complying funds), with effect from 1 July 1988. The new taxing arrangements proposed by the Bill are to apply to the following classes of complying funds :

- . superannuation funds established by employers to provide benefits for their employees and dependants;
- . personal superannuation funds, often used by self-employed persons and employees who do not receive employer superannuation support;
- . public sector superannuation funds generally;
- . approved deposit funds; and
- . pooled superannuation trusts which are established as investment vehicles for complying superannuation and approved deposit funds.

All of the complying funds listed above are to be taxed on their income under a new Part IX of the Income Tax Assessment Act 1936 at the rate of 15%. While generally the taxable income of these funds will be determined in the same way as for other taxpayers there will be some differences in the treatment of funds' assessable income and allowable deductions. The Bill will exempt from tax any part of a fund's income that accrued before 1 July 1988, even if it was derived after 30 June 1988. For instance, if a fund held an interest bearing investment, any interest accrued but not paid at 30 June 1988 will not be taxed when it is received by the fund. Special rules will be included in a later Bill to provide for the treatment of capital gains derived by complying funds as announced in the May 1988 Economic Statement.

Under another provision proposed by this Bill, superannuation funds and approved deposit funds are to be taxed on certain contributions and amounts rolled over to a fund. These taxable contributions will be included in a fund's assessable income. Amounts which will be taxable are :

5.

- . all contributions made to a superannuation fund by an employer on behalf of employees;
- . contributions made to a personal superannuation fund by a fund member, to the extent that the contributions are deductible to the member; and
- . the post-30 June 1983 components of rolled-over eligible termination payments paid by employers, e.g. golden handshakes, and any eligible termination payments sourced in a fund held not taxable under the new arrangements.

Other features of this aspect of the Bill are :

- . where a superannuation fund pays benefits in the form of pensions, part of the investment earnings of the fund will remain tax exempt. The exemption will apply to the proportion of a superannuation fund's income which its current pension liabilities bears to its total liabilities;
- . superannuation funds are to receive full imputation rebates notwithstanding that part of a fund's franked dividend income may be exempt because the fund has current pension liabilities;
- . the cost to a complying superannuation fund of providing death and disability benefits is to be deductible to the fund in order to allow funds to continue to provide after tax benefits at the same level as before introduction of the tax on superannuation contributions;
- . deductions for expenditure incurred by a superannuation fund or approved deposit fund are not to be reduced because of the receipt by the fund of non-taxable contributions (for example, non-deductible employee contributions to a superannuation fund);

Application to State government and other statutory funds
(Clause 9)

The above arrangements are also to apply to superannuation funds or unit trusts established by a law of the Commonwealth or by the law of a State or Territory and to those established by statutory authorities.

However, to avoid any possibility of infringement of section 114 of the Commonwealth Constitution, which prohibits the Commonwealth from imposing tax on any property of a State, the new law will contain a safeguard which will prevent the application of the new provisions if they would have that effect.

Transfer of liability to tax on contributions
(Clause 9)

The Bill also makes provision for a complying superannuation fund or approved deposit fund which invests in a pooled superannuation trust, or a complying superannuation fund which purchases a life assurance policy, to arrange with the relevant trust, life office or registered organisation for the transfer of the unitholder's or policy owner's liability to tax on taxable contributions. That may be done by transfer of an amount of assessable income. Where agreement is reached between the relevant parties, the amount of assessable income transferred will be included in the assessable income of the pooled superannuation trust, life office or registered organisation and there will be a corresponding reduction in the assessable income of the transferor fund.

Taxation of non-complying superannuation funds
(Clause 9)

This Bill proposes amendments that will change the way in which non-complying superannuation funds (those that do not receive a notice of compliance with the Occupational Superannuation Standards Act conditions) are taxed. In the past, superannuation funds which have failed the tests for exemption from tax have been taxed on their income at various rates. Funds which failed the superannuation standards other than the loan-back restrictions (known as section 121 DAB funds) have been taxed on their income at the rate of 40%. Funds which failed the loan-back standard only (so-called section 121CC funds) were taxed at 24%. Still other funds which did not meet the definition of a superannuation fund in the Occupational Superannuation Standards Act (section 121DA funds) were taxed at 49%.

Under this Bill it is proposed that there will be only one class of non-complying superannuation funds with the income of such funds, including contributions by employers, to be taxed at the top marginal rate of tax (presently 49%).

Pooled superannuation trusts
(Clauses 9 and 16 and Schedule 2)

Pooled superannuation trusts are trusts that act as investment vehicles for other complying funds, including other pooled superannuation trusts. To be treated as a pooled superannuation trust a trust will need to satisfy conditions being inserted by this Bill in the Occupational Superannuation Standards Act 1987. If the Insurance and Superannuation Commissioner is satisfied that a trust meets those conditions or should be treated as having done so he will give the trustee a notice of compliance. If a trust does not comply it will fall to be taxed under the general trust provisions of the income tax law.

Pooled superannuation trusts are to be taxed on their income in the same way as complying superannuation funds and approved deposit funds. A complying fund that invests in a pooled superannuation trust will not be taxed on its share of the income already taxed in the trust's hands. In addition, the sale by a complying fund of units in a pooled superannuation trust will not give rise to a capital gains tax liability.

Deductions for employer superannuation contributions
(Clause 10 and Schedule 1)

This Bill proposes to remove, with effect from 1 July 1988, the restrictions in the income tax law on the deductibility of superannuation contributions made by employers on behalf of employees. Under the existing law there is a statutory restriction on the amount that may be allowed as a deduction to an employer in respect of an employee although the Commissioner of Taxation has a discretion to allow a greater deduction if he considers it reasonable. The statutory limit is \$400 or 5% of the employee's salary, whichever is greater. The Commissioner has allowed greater deductions in the past for contributions necessary to provide superannuation benefits for an employee which could be expected to be within the reasonable benefit limits set down by the Commissioner (but now supervised by the Insurance and Superannuation Commissioner). Apart from the statutory restriction just referred to, contributions made by an employer to a section 121CC or section 121DA fund are expressly not deductible.

Under amendments proposed by the Bill, all superannuation contributions made by an employer are to be deductible. Correspondingly, relevant contributions will be taxable in the hands of the superannuation fund, at the rate of tax applicable to the fund. There will still be controls on the amounts that may be contributed to a concessional tax (at 15%) complying superannuation fund since the fund will need to satisfy the Insurance and Superannuation Commissioner that it is providing benefits within the reasonable benefits limits. Contributions to funds that do not gain a notice of compliance with the Occupational Superannuation Standards Act conditions will be taxed at the rate of 49%.

Another amendment proposed by the Bill will restrict deductions for employers to amounts actually paid to a superannuation fund. The proposed amendment is to apply from the date of introduction of this Bill. At present, employers are entitled to deductions for amounts paid or set apart to provide superannuation benefits for employees. It has, therefore, been possible for employers to obtain deductions for amounts not paid into a superannuation fund but merely set apart. Consistent with the proposal to tax superannuation contributions made by

employers to superannuation funds, from the date of introduction of the Bill, only amounts paid into funds, and thus subject to contributions tax, will be deductible.

Increased deduction for contributions to personal superannuation funds

(Clause 10 and Schedule 1)

Self-employed persons are entitled to a deduction of up to \$1,500 for contributions made to a personal superannuation fund to provide for their retirement. A deduction is also available to employees who have no superannuation support from an employer other than any employer provided superannuation benefits under certain industrial agreements (e.g. the so-called "3% productivity" arrangements).

This Bill proposes to increase the maximum deduction allowable to these persons from \$1,500 to \$3,000, with effect from the 1988/89 year of income.

Other consequential amendments of the Income Tax Assessment Act 1936 relating to superannuation funds

(Clause 10 and Schedule 1)

Schedule 1 of the Bill contains a series of amendments which are consequential on the enactment of the new Part IX of the Income Tax Assessment Act 1936. Most of these are merely mechanical, changing references to repealed sections to references to the new Part or made for the purposes of facilitating the operation of the new Part, including the availability of franking rebates on franked dividend income received by superannuation funds, approved deposit funds and pooled superannuation trusts.

Also contained in the amendments made by clause 10 and Schedule 1 are the repeal of certain provisions made redundant by the new arrangements discussed above.

Consequential amendments of other Acts

(Clause 16 and Schedule 2)

Occupational Superannuation Standards Act 1987

As indicated above, a pooled superannuation trust will need to satisfy conditions set down in the Occupational Superannuation Standards Act 1987. Those conditions are provided under new sections 6A and 8A of that Act and the certification process (similar to that applying to superannuation funds and approved deposit funds) is provided under new sections 15B and 15C of that Act.

Other mechanical amendments inserting references to pooled superannuation trusts are also made to that Act under Schedule 2.

Fringe Benefits Tax Assessment Act 1986
Taxation Administration Act 1953

Schedule 2 also contains mechanical amendments to these Acts consequential on the amendments made under the provisions mentioned above.

Superannuation Act 1976

The amendments made to this Act under Schedule 2 will ensure the application of the new taxation arrangements for superannuation funds to the income of the Commonwealth Superannuation Fund established under this Act.

Life insurance companies
(Clause 5)

The Bill will give effect to proposals, announced in the 1988 May Economic Statement, to abolish the deduction under section 115 and the exemption under section 116 of the Income Tax Assessment Act 1936 relating to the calculated liabilities of a life insurance company, as from the 1988-89 income year. Under section 115, a life company is allowed to claim a special deduction equal to 1 per cent of its calculated liabilities, whereas section 116 provides that such a company is exempt from tax on income from its life insurance business if, in a particular year, the value of calculated liabilities is greater than the value of its assets.

Share cancellations
(Clauses 6, 7 and 8)

This Bill will give effect to the proposal announced on 11 August 1988 to amend the Income Tax Assessment Act 1936 in respect of certain arrangements where a holding company cancels shares in itself that are held by a subsidiary of the holding company. The arrangements may result in a benefit, ie. broadly, a reduction in the tax liability (in the current or a future year of income) of the holding company and the subsidiary.

The proposed amendments will apply where :

- . a holding company cancels (or redeems) shares in itself that are held by a subsidiary of the holding company (the relationship of holding company to subsidiary company is determined according to company law); and
- . the consideration, if any, received by the subsidiary company for the cancellation is less than the market value of the shares at the time of the cancellation.

In these circumstances the subsidiary company will be taken to have received, as consideration for the cancellation, an amount equal to the market value of the shares. The effect of the amendment is to ensure that no untoward benefit accrues to the subsidiary company as a result of the cancellation, that is, the tax position of the subsidiary will be the same as it would have been had the shares been disposed of for an arm's length consideration.

The cancellation of the shares held by the subsidiary company for less than their market value causes the value of the subsidiary to fall, which in turn reduces the value of the holding company's interests (i.e. shares or securities) in the subsidiary company. The end result would be a benefit arises to the holding company on the subsequent disposal of its interest in the subsidiary company; the holding company's assessable income could thus be reduced or it may incur an income or a capital loss.

The Bill also proposes an amendment which will prevent the holding company from obtaining any benefit when it cancels shares in itself that are held by a subsidiary company for less than their market value. This will be achieved by reducing the acquisition cost, or by increasing the proceeds on disposal, of the holding company's interest in the subsidiary by an amount that ensures any assessable income, allowable deduction, capital gain or capital loss (as the case may be) in respect of the acquisition or disposal of the holding company's interest in the subsidiary will not be reduced or increased because of the share cancellation. The amount of the adjustment will be calculated by first determining the proportion of the total interests in the subsidiary that are held by the holding company, and then applying that proportion to the adjustment that was made to the consideration (if any) received by the subsidiary company for the cancelled shares (i.e., the difference between the market value of the shares cancelled and any consideration received).

Where the holding company holds an interest in the subsidiary company indirectly through one or more interposed entities, an adjustment will be made to each interest held by the holding company and the interposed entities directly in the subsidiary and directly in any interposed entity. As with the holding company the adjustment will prevent these entities from obtaining an undue benefit, by reason of the share cancellation, on the acquisition and disposal of their interests.

The Bill proposes a further amendment which will apply where the holding company or an interposed entity disposes of an interest in the subsidiary company or another interposed entity prior to the cancellation of the shares held by the subsidiary for a consideration which is reduced because of the impending cancellation. In these

circumstances, by disposing of the interest prior to the cancellation, the holding company or interposed entity would obtain the benefit which it is proposed to eliminate. Accordingly, in such a case under the proposed amendment the holding company or interposed entity will be taken to have received, as consideration for the disposal of the interest, an amount equal to its market value disregarding the impending cancellation.

The provisions which will prevent the holding company and the interposed entities from obtaining a benefit as a result of the cancellation of the shares will also apply to a natural person associate of the holding company who holds interests in the subsidiary company directly, or indirectly through interposed entities. Adjustments similar to those which apply to the holding company and the interposed entities will apply to the associate and any interposed entities through which he or she indirectly holds an interest in the subsidiary company.

The proposed amendments apply to a cancellation or redemption of shares confirmed by a court after 11 August 1988, whether or not the cancellation or redemption has effect from an earlier date. Where a cancellation or redemption of shares is not subject to confirmation by a court, the proposed amendments apply where the cancellation or redemption occurs after 11 August 1988.

Approved research institutes
(Clauses 4 and 13)

Under section 73A of the Income Tax Assessment Act 1936, a deduction is allowable for certain payments made to an appropriate research institute by a taxpayer who carries on a business for the purpose of producing assessable income. A payment is deductible if it is made to an institute :

- . for scientific work related to the taxpayer's business; or
- . which undertakes scientific work related to the taxpayer's class of business.

An "approved research institute" is, broadly, the CSIRO or any university, college, institute, association or organisation which is approved by a number of specified approving authorities, including the secretaries of certain Commonwealth Government Departments. The amendments proposed by the clause will alter the list of specified Departments to reflect both Machinery of Government changes made in July 1987 and changes in responsibilities between some Departments.

The amendments will apply from the date on which the Bill receives the Royal Assent.

A transitional provision will preserve approvals made before the amendments came into operation.

INCOME TAX RATES AMENDMENT BILL (NO. 2) 1988

The Bill will amend the Income Tax Rates Act 1986 to ensure that tax at the rate of 15% applies to the taxable contributions and income derived by funds and pooled superannuation trusts. However, the Bill will maintain the existing 49% rate of tax for the excessive non-arm's length income of superannuation and approved deposit funds and extend that rate to such excessive income derived by pooled superannuation trusts.

INCOME TAX AMENDMENT BILL (NO. 2) 1988

This Bill will amend the Income Tax Act 1986 to ensure that if the proposal to tax both the contributions and the other income derived by superannuation funds and approved deposit funds would be in breach of the Constitution, because it is found to deal with 2 subjects of taxation, then that Act will impose tax only on that other.

INCOME TAX (FUND CONTRIBUTIONS) BILL 1988

This Bill is related to the proposed amendment of the Income Tax Rates Act 1986. If for Constitutional reasons that amendment would apply to tax the income of superannuation funds and approved deposit funds only and not their taxable contributions, this Bill will operate to impose tax on the taxable contributions of such funds.
