

# Exposure Draft Legislation, CGT rollover for complying superannuation funds with capital losses

ASFA Submission

September 2009

Association of Superannuation Funds of Australia

ASFA Secretariat  
Level 6  
66 Clarence Street  
Sydney NSW 2000

PO Box 1485  
Sydney NSW 1005  
Ph: +61 2 9264 9300  
Fax: +61 2 9264 8824

Outside Sydney  
1800 812 798

Website: [www.superannuation.asn.au](http://www.superannuation.asn.au)

The Association of Superannuation Funds of Australia Limited ABN 29 002 786 290 ACN 002 786 290

**Please Note:**

This background paper provides general information and is not intended as advice specific for any individual superannuation fund or investment manager's portfolio. Although verification of the accuracy of the information contained in this paper has taken place, liability is not accepted for any errors or omissions that may have occurred.

© ASFA 2009

The General Manager  
Business Tax Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600

cgt\_super\_roll-over@treasury.gov.au

Dear Sir

## **Submission on Exposure Draft Legislation CGT rollover for complying superannuation funds with capital losses**

Attached please find a response from the Association of Superannuation Funds of Australia to the release by Treasury of Exposure Draft legislation and Explanatory Memorandum (ED/EM) for proposed *Tax Laws Amendment (2009 Measures No. 6) Bill 2009: Loss roll-over for merging superannuation funds*.

ASFA is a non-profit, non-political national organisation whose mission is to protect, promote and advance the interests of Australia's superannuation funds, their trustees and their members. Our members, which include corporate, public sector, industry and retail superannuation funds, account for more than 5.7 million member accounts and over 80% of superannuation savings.

ASFA welcomes this initiative by the Government, which seeks to address an issue critically affecting the superannuation industry in the present financial climate, and commends the Government on its timely response to this issue.

On the following pages we have addressed the specific issues that arise from the ED/EM.

Should you require any additional information please contact our principal policy adviser, Robert Hodge at rhodge@superannuation.asn.au or on (02) 8079 0806.

Melinda Howes  
Director Policy and Industry Practice

# EXPOSURE DRAFT LEGISLATION

## ***Tax laws Amendment (2009 Measures No. 6) Bill 2009: Loss roll-over for merging superannuation funds***

ASFA considers that the approach set out in the ED/EM is broadly consistent with the Government's announcements of 23 December 2008 and 29 April 2009, and that this approach addresses most industry concerns in respect of the issues associated with capital losses within superannuation funds. We note however that the ED/EM do not consider extending the rollover relief to all superannuation entities.

However, the drafting, particularly of Section 310-10(1) has introduced some requirements which are either unclear, or result in a loss of relief in circumstances where the policy clearly intended relief to apply. Some of these circumstances include where:

- only cash assets are transferred; or
- some assets are transferred to a PST (or life policy) in which the ongoing entity is invested and some are transferred to the ongoing entity itself (for example, most investment assets to the PST but cash and office plant to the ongoing fund); or
- there are some transactions which occur after the first transfer of assets has occurred but before the transfer has been finalised; or
- there are some members remaining in the fund which is being wound up (for a short period whilst calculations for the precise entitlements for these members are being finalised; or
- the transfer events occur over more than one year.

Critically, some transfers which have already been undertaken and for which the relief was intended, may now not be able to access the relief based on the specific conditions in the ED to qualify for the relief. The uncertainty created by the draft legislation has also resulted in proposed transfers being placed on hold while the situation is clarified through the passage of legislation.

The comments below address in more detail the specific technical issues associated with the ED/EM, and also comment on the breadth and coverage of the proposal.

Legislative references are to the *Income Tax Assessment Act 1997*, as amended, unless otherwise noted.

### **1. Recommencement of ownership period within the continuing entity**

Where an actual asset is rolled over, as distinct from the transfer of a realised capital or revenue loss, the operation of the proposed legislation appears to result in the re-commencement of the ownership period within the continuing entity.

In other words, there appears to be no rollover of the original acquisition date from the original entity to the continuing entity.

This results in a requirement that the continuing entity hold the asset for at least 12 months before being entitled to the CGT discount on disposal, and may result in issues arising pursuant to the "45 day rule" for franking credits.

Both of these results appear to be inconsistent with most other existing mechanisms for CGT rollover within the income tax legislation, which do provide for the maintenance of the original acquisition date.

ASFA recommends that the legislation be amended to provide for the maintenance of the original acquisition date.

### **2. Transfers must occur within a single income year**

Clause 310-10 requires that the transfer events all happen in a single income year.

This requirement may present difficulties where the merger date is 30 June in any year. In many cases, the inconsistency between the successor fund rules in superannuation legislation, requirements within fund trust deeds,

and the requirements of funds' master custodians and administrators, can mean that, for some purposes, transfers associated with a merger date of 30 June may be processed as occurring at the commencement of the first day of the following tax year (that is, on 1 July).

It may also be the case that the final entitlements of members within the original entity cannot be precisely determined as at the merger date. In these circumstances, it is not unusual for funds to hold back some of members' entitlements in cash, in order both to pay its existing or expected debts, but also in full expectation that a second (typically much smaller) transfer of cash from the original entity to the continuing entity will occur once the final entitlements of members are determined.

It is noted that the 'single year' requirement was not in the Minister's announcements of 23 December 2008 or 29 April 2009 and that certain fund amalgamations that occurred on 30 June 2009 in expectation of gaining relief may have already failed this test.

We also note that the reference to a single income year does not make reference to whose year of income is to apply (that is, whether this is the income year of the original entity or the continuing entity). In this regard, ASFA notes that there are still a number of superannuation entities that have substituted accounting periods (SAPs).

ASFA recommends that Treasury consider removing this requirement or replacing it with a requirement that the transfer must be completed within 12 months of the first transfer date.

In the absence of the removal or amendment of the requirement, clarification is required regarding the year that is to be taken into consideration and the treatment to apply where the merging entities do not have the same income year.

### **3. Original entity must cease to hold all of its CGT assets**

This requirement may also present difficulties in those circumstances where the final entitlements of members within the original entity cannot be precisely determined as at the merger date.

The legislation contemplates that cash may continue to be held by the original entity to pay its existing or expected debts, but many funds hold back more cash than this raw calculation of expected debts, to allow for potential movements in the final calculation of members' entitlements.

ASFA recommends modifying this by the inclusion of a 'within 12 months of the first transfer' requirement.

### **4. Together, the identical assets are identical to all the original entity's CGT assets just before the time the first set of transfer events happens (s. 310-10(1)(c))**

In addition to the meaning of this provision being unclear, it ignores the fact that the transfer may occur over a period of time (albeit quite small) and may involve certain assets being converted to cash where the asset is not compatible with the receiving fund's investment strategy, or where assets must be realised to permit the finalisation/transfer of benefits for lost members or recently exited members.

Similarly, where units are held in a PST the merger may be achieved by cashing out the units or by the distribution of the underlying assets. In both circumstances the requirement that the continuing fund hold identical assets as at commencement will not be satisfied.

In the absence of a specific mischief being identified, it is recommended that this requirement be removed.

### **5. The original entity must cease to have members**

Similarly, to the extent that cash is retained by the original entity, in excess of the amount of expected debts, the original entity continues to have members. Any such excess represents members' entitlements, and in many cases, will form part of a second (typically much smaller) transfer of cash from the original entity to the continuing entity upon finalisation of calculation of members' entitlements.

In addition, there can be impediments to the original entity ceasing to have any members at all. ASFA is aware, for example, of instances where the Family Court places an order freezing a member's account, such that this account must stay in the closing fund until this order is lifted.

ASFA recommends modifying this by the inclusion of a 'within 12 months of first transfer' requirement.

## **6. The original entity does not include an approved deposit fund**

No roll-over relief appears to be available where the original entity is an approved deposit fund. This appears to be an oversight, and ASFA recommends that roll-over relief be extended to these entities (which are akin to complying superannuation funds in most relevant respects).

## **7. CGT Assets must be transferred to other entity**

In some mergers the merger agreement requires the closing fund's assets to be realised with the cash proceeds transferred to the ongoing fund. ASFA considers that this disposal followed by a transfer of cash is consistent with the requirements of s.310-10(1)(a). However, for clarity, it is requested that s. 310-10(1)(a) makes it clear that losses may be rolled over in these circumstances (i.e. clarify that cash is an asset).

Similarly, as part of a merger of Superfund A with Superfund B, the legislation should permit a cash transfer from a PST to Superfund A for transfer to Superfund B, or a transfer of cash from the PST direct to Superfund B.

In support of such processes outlined above, and generally where there is a transfer of value from a PST as part of the merger process, it may be necessary for the legislation to provide a formula for determining the quantum of realisable losses available to be transferred.

## **8. CFC and FIF attribution accounts**

ASFA is aware of some potential fund mergers where the closing fund may have accrued income pursuant to the Controlled Foreign Corporation (CFC) or Foreign Investment Fund (FIF) attribution measures.

The CFC and FIF rules include provisions, based on attribution accounts, to act against double taxation, by providing an exemption for income subsequently received, or reduction to capital gains subsequently accrued, to the extent that assessable income has been included pursuant to these rules.

If the closing fund has a balance in its attribution account, there is no present capacity to transfer or roll-over this balance to the ongoing fund. In this way, the ongoing fund may be required to include assessable income, which was effectively already brought to tax in the closing fund in the years prior to merger.

ASFA recommends that consideration be given to facilitation of a mechanism for transfer of CFC and FIF attribution accounts in fund merger situations.

## **9. Section 290-170 notices and no-TFN contribution amounts**

Section 290-170 deals with the procedures by which a member can claim deduction for personal contributions made to a superannuation fund. A section 290-170 notice is not valid (per section 290-170(2)) if, at the time it is provided, the contribution is no longer held by the fund to which it was made.

In a fund merger situation, a valid section 290-170 notice cannot be made subsequent to the merger date, for any contributions received by the closing fund. This is because the ongoing fund was not the fund to which the contribution was made, and the closing fund is no longer the holder of the contribution.

ASFA recommends that consideration be given to facilitation of an exception to this general rule in section 290-170, to enable the ongoing fund to accept a valid section 290-170 notice for contributions made to the closing fund.

Similarly, if the closing fund has applied the additional 31.5% tax for no-TFN contributions, pursuant to section 295-610, the mechanism for offset in section 295-675 where the member subsequently provides his or her TFN does not work.

ASFA recommends that consideration be given to facilitation of a mechanism for the ongoing fund to claim the offset in section 295-675 where a member provides his or her TFN in respect of no-TFN contributions amounts included by the closing fund in its income tax returns prior to the merger date.

## 10. Breadth of the measures & other rationalisations

The ED/EM makes clear that the roll-over is not available for “routine transfers of assets between funds where both funds continue to have members”.

In practice, the roll-over of assets from superannuation funds is limited to:

- Transfer of assets/members from Superfund A to Superfund B, where Superfund A then closes;
- Transfer of assets from Superfund A to PST B, where the members of Superfund A then become members of Superfund B (which holds the units in PST B), and thus where Superfund A then closes;
- Transfer of assets from Superfund A to Life Coy B, where the members of Superfund A then become members of Superfund B (which holds the life policies in Life Coy B), and thus where Superfund A then closes;
- Transfer of all assets within PST A that support the units held by Superfund A, to either Superfund B, PST B or Life Coy B, where Superfund A then closes; or
- Transfer of all assets within Life Coy A that support a life policy held by Superfund A, to either Superfund B, PST B or Life Coy B, where Superfund A then closes.

Another method of achieving consolidation, but which does not appear to be provided for in the legislation, is where Fund A's assets are held within a PST and the transfer of the assets to fund B involves a two step process – PST to Fund A, Fund A to Fund B.

Additionally, the provisions do not contemplate the situation where a superannuation fund merges with multiple other entities. The provisions talk of “held by one of”. It is possible that divisions of members may be transferred to separate entities as part of a winding up/merger process. This is particularly the case where the merging fund has both defined benefit and defined contribution divisions, as administration of defined benefits is highly specialised and is not available within many potential continuing entities.

ASFA requests that both these arrangements be provided for.

## 11. Transfers from PSTs – sections 310-30 and 310-35

Sections 310-30 and 310-35 require that for tax losses or capital losses to be transferred then the PST or Life Co must:

- choose rollover; and
- determine the current year and prior year losses by only considering the original assets

Original assets are defined at 310-15(1)(c) and 310-20(1)(c) as the assets held just before the transfer time. As prior year capital losses are in respect of assets disposed of in earlier years, this restriction would appear to defeat the intent of the legislation.

The EM (at 1.51 to 1.53) indicates that you can transfer prior year losses from a PST. However it would appear that the intent is to restrict the transfer to “your share” of the losses on the assumption that there may be multiple investors in the PST.

As noted, this restriction applies only to transfers where the original entity is a PST or Life Co, and not to transfers where the original entity is a complying superannuation fund. It is not wholly clear from the ED/EM why this restriction is required for the transfers where the original entity is a PST or Life Co, and not where the original entity is a complying superannuation fund.

ASFA suggests that the wording of these provisions be reviewed with an aim to achieve greater clarity and the policy intent that the fund be able to transfer its share of the CGT losses held by the PST.

Additionally, as with 7 above, it may be necessary for the legislation to provide a formula for determining the quantum of realise losses available to be transferred

## **Further Policy Considerations**

ASFA considers that there are other relevant mechanisms for rationalisation, and superannuation industry consolidation, which do not require Superfund A to close.

In particular, ASFA submits that consideration be given to the extension of the rollover to four other circumstances:

- Where a smaller superannuation fund joins the investment platform of a larger fund or group of funds;
- Where two funds both transfer their assets to a newly-created entity; and
- Where two superannuation-related investment platforms merge.
- Where two or more funds are investors in a common PST and as part of a merger and rationalisation process the three funds merge into a single entity followed by the wind up of the PST with, subsequently, all assets being directly held by the single superannuation fund.

We deal with each of these circumstances in turn.

### ***1. Small fund joining investment platform of a larger fund or group of funds***

This situation occurs where Superfund A transfers all of its existing assets to:

- PST B, where it and Superfund B (or indeed it and several other super funds) become the holders of units in PST B; or
- Life Coy B, where it and Superfund B (or indeed it and several other super funds) become the holders of life policies with Life Coy B.

This type of rationalisation does not result in a reduction in the number of superannuation funds per se, but does result in consolidation of the investments of superannuation funds, and thus, the likely reduction in fees to superannuation fund members.

For many smaller superannuation funds, the primary additional costs of operation are not due to being a separate fund, but to the smaller quantum of investments held (and thus, the proportionately higher investment management fees incurred). Rationalisations which enable smaller funds to pool their investments within larger funds would assist in addressing these cost differentials, and translate to savings in fees incurred by fund members. However, in the same way as full fund mergers, the present issues associated with maintenance of the benefits associated with capital and revenue losses acts as a critical impediment to such rationalisation.

This type of rationalisation could be facilitated within the existing roll-over relief set out in the ED/EM, if a separate clause were inserted, enabling a trustee of a complying superannuation fund to choose to obtain a rollover if:

- (a) one or more CGT events (the transfer events) happened because the complying superannuation fund (the original entity) transfers all of its then CGT assets, except cash and such items as plant and equipment, petty cash, prepayments; and
- (b) because of the transfers, CGT assets (the identical assets) become held either by:
  - (i) a single pooled superannuation trust (the PST); or
  - (ii) a single life insurance company (the Life Company); and
- (c) together, the identical assets are identical to all the original entity's CGT assets just before the time the first of the transfer events happens (the original assets); and
- (d) the original entity holds only cash and/or units in the PST (or policies in the Life Company) just after the time (the completion time) the last of the transfer events happens; and
- (e) the transfer events all happen in a single income year (the current year).

## ***2. Two funds transferring assets into a newly-created entity***

Most superannuation fund mergers occur through the mechanism of one fund (fund A) transferring all of its assets to the other fund (fund B) and then fund A closing.

However, depending on the rules of particular funds, it may sometimes be the case that both fund A and fund B wish to merge by way of transferring their assets to a newly-created superannuation fund (fund C).

In these circumstances, the condition in clause 310-10(1)(e) may not be satisfied, as fund C would have less than 5 members (indeed, would have no members) immediately before the first of the transfer events.

## ***3. Merger of superannuation-related investment platforms***

In the same way that the absence of rollover relief acts as an impediment to the merger of superannuation funds, the absence of such relief also acts as an impediment to the merger of PSTs, or of the superannuation business of life insurance companies.

Such mergers would also enable consolidation in the number of entities, and result in an increase in the average size of the investments held by the PSTs and superannuation business within life insurance companies that would then remain, and this itself would drive the broad intention that fees to investors (superannuation funds) be reduced.

## ***4. Merger of funds and rationalisation of underlying investment structures***

This situation occurs where multiple superannuation funds (say superfund A, Superfund B and Superfund C) are common, and the only investors/unit holders in PST A.

Superfund A and Superfund B transfer their assets (the units in PST A) to superfund C.

Subsequently Superfund C, being the sole unit holder in PST A closes the PST and transfers all assets to Superfund C.

This type of transfer rationalises both the number of funds, three funds into one, and the investment arrangements, the PST investment vehicle is dismantled.

ASFA recommends that Treasury consider whether the roll-over relief should be broadened to capture each of the above circumstances.

This would address most product rationalisations or consolidations involving superannuation funds, without at this stage considering the broader product rationalisation issues within investment managers (for example, the more difficult issues associated with product rationalisation of managed investment trusts and/or life insurance policies).