SUBMISSION

Submission to Board of Taxation — Review of CGT Roll-overs

5 June 2020

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Board of Taxation Secretariat

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Via email: CGTrollovers@taxboard.gov.au

5 June 2020

Dear Sir/Madam

Review of CGT Roll-overs – Consultation Guide

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to the Board of Taxation's *Review of CGT Roll-overs – Consultation Guide* (the Consultation Guide) released in February 2020, and further to our attendance at a roundtable consultation session held in Melbourne on 20 February.

ASFA is a non-profit, non-political national organisation whose mission is to continuously improve the superannuation system, so all Australians can enjoy a comfortable and dignified retirement. We focus on the issues that affect the entire Australian superannuation system. Our membership is across all parts of the industry, including corporate, public sector, industry and retail superannuation funds, and associated service providers, representing almost 90 per cent of the 16 million Australians with superannuation.

If you have any queries or comments in relation to the content of our submission, please contact me on (03) 9225 4027 or by email jstannard@superannuation.asn.au.

Yours sincerely

Julia Stannard
Senior Policy Advisor

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A. General comments

ASFA welcomes the Board of Taxation's review of the capital gains tax (CGT) roll-over rules, and the opportunity to provide this submission.

As explained during our consultation session on 20 February, ASFA has two main points of focus in relation to this consultation:

- the operation of Division 310 of the *Income Tax Assessment Act 1997* (the ITAA 1997), which is specifically referenced within the Consultation Guide in the context of business reorganisations which allow for changes in underlying economic ownership[1]; and
- the need to expand current business restructuring rules for corporate groups so that these are available to entities within structures that are wholly-owned by large superannuation funds.

The CGT roll-over and loss transfer rules provided for within Division 310 are critical to ongoing consolidation within the superannuation industry, as recognised by the recent passage of amending legislation[2] to make this tax relief permanent, which ASFA warmly welcomes.

As highlighted during our consultation session on 20 February, ASFA has identified three broad areas where we consider that the application of the CGT roll-over provisions in relation to superannuation funds could be improved:

1. improvements to the existing Division 310 roll-over relief for merging funds;
2. ways of allowing post-merger rationalisation of structures and realisation of losses; and
3. extension of CGT roll-over relief to allow for the rationalisation of structures in response to organic growth of funds, outside of a merger situation.

As requested by the working group formed by the Board of Taxation to undertake this review, we are pleased to make this initial submission in response to the Consultation Guide, providing high-level comments on these matters.

In this submission, generally speaking, the term 'superannuation funds' should be read as including pooled superannuation trusts (PSTs)[3], as is relevant to the operation of Division 310 and other tax provisions.

We understand that the Board will release a more detailed discussion paper in due course, in response to which ASFA may make a more detailed submission.

Finally, we note that aside from ensuring that appropriate tax relief arises upon a fund merger by way of CGT roll-over and tax loss transfer pursuant to Division 310 as outlined in this submission, there are a number of other tax related issues which act as an impediment to funds undertaking mergers.

ASFA has previously raised many of these impediments with the Board as part of a response dated 25 June 2019 to the Board's letter dated 9 April 2019 (specifically in Attachment B). ASFA acknowledges that these matters are outside the Terms of Reference for the current review, but would be pleased to provide the Board with additional information on them to supplement this submission.

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[1] Superannuation funds may also be affected by various other existing CGT roll-overs (such as under the small business CGT concessions or upon corporate actions relating to investments), however these are not considered within this submission.

[2] *Treasury Laws Amendment (2020 Measures No. 1) Act 2020*

[3] Except where specific issues relating to PSTs are highlighted in the submission.

B. Improvements to the existing CGT roll-over relief rules

ASFA has identified a number of potential improvements to the CGT roll-over rules as they apply to superannuation funds. These are summarised in Table 1 below, and further detail is provided in Appendix A and Appendix B to this submission.

Table 1: Summary of ASFA suggestions for improvement to CGT roll-over rules

	Category	Description of current issue	Practical impact of current position	Suggestion for improvement	Relevance to terms of reference	Relevance to policy considerations for reform
1.	Enhancement and simplification of existing CGT roll-over relief under Division 310	Division 310 is structurally deficient and does not allow for the tax efficient transfer of members and their assets from SMSFs to large superannuation funds, and from sub-plans within large superannuation funds to other large superannuation funds.	Tax acts as a barrier to such transfers, as CGT and other tax liabilities may be crystallised, and tax losses may be forfeited. SMSFs and sub-plan arrangements may be retained notwithstanding they are inefficient or otherwise not desirable for the member, due to the tax detriments that may arise under the current law.	That Division 310's operation be enhanced to allow for tax relief in these circumstances.	Consistent with the purposes for the existing Division 310 relief, it is submitted that this is a form of desirable business reorganisation which allows for changes in underlying economic ownership.	The proposed enhancements to Division 310 would align with the policy consideration to reduce the effects of 'asset lock-in'. That is, the absence of CGT roll-over relief may distort decisions as to the allocation of capital in the form of retirement savings for members of SMSFs and within sub-plans.
		The current design of Division 310 includes some unduly prescriptive rules and raises various tax technical issues which are unnecessarily complex to navigate. For example, the requirement for a merger agreement and the successor fund transfer (SFT) to occur in the same income year may not be practicable.	Managing these issues arising under Division 310 adds to the time, cost and complexity of undertaking a SFT, particularly in light of their significance to the overall SFT.	That Division 310 and related CGT and other tax law provisions are amended to provide certainty on the outcomes.	Simplification of what is considered to be unnecessary complexity with the current design of Division 310.	The suggested improvements address a current technical 'black letter' requirement which can make navigating the law difficult, where there is no mischief.

	Category	Description of current issue	Practical impact of current position	Suggestion for improvement	Relevance to terms of reference	Relevance to policy considerations for reform
2.	Enhancement of existing loss transfer relief under Division 310	The loss transfer relief aspect of Division 310 is also too narrow and not reflective of the structures which large superannuation funds today commonly have in place, whereby entities may be established for various commercial reasons. A fund merger can cause unused tax losses within such entities (particularly trusts) to be permanently lost, which again represents an impediment to industry consolidation and should be addressed.	If a SFT involves the transfer of units in a unit trust which has unused tax losses, the SFT may trigger a failure of the 50% stake test. The extinguishment of tax losses within an investment structure may be a barrier to a superannuation fund merger.	Division 310 could be expanded to allow for the transfer of losses from the underlying entity (typically a trust) to the continuing fund for losses which would otherwise be extinguished on the SFT. Alternatively, Schedule 2F (trust loss testing rules) could be amended such that the 50% stake test will not be failed due to a SFT.	The underlying economic ownership for the relevant unit trust, does not change to the extent that the ultimate beneficiaries (superannuation fund members) still continue to exist albeit their interest is within the merged superannuation fund (being the continuing fund in the context of a fund merger).	Roll-over relief can relieve the unfair consequences to a unit trust as a result of a SFT that has caused trust losses to be extinguished. Under the current law, a superannuation fund that has the same economic loss can be treated differently depending upon whether the asset that generated the loss was held directly or via a wholly owned trust.
3.	Broadening of the CGT roll-over relief for asset reorganisations undertaken by superannuation funds (outside of a merger).	In light of the increased sophistication of the industry the CGT roll-over rules should allow flexibility for superannuation funds to undertake certain asset holding reorganisations without the barrier of bringing forward a CGT liability that would otherwise only be payable at a later time on sale of the assets.	Investments held by superannuation funds can over time accumulate inefficiencies within the investment holdings. The CGT roll-over relief provisions currently available under the tax law are primarily focused on corporate restructures. As such, in the absence of broadened CGT roll-over relief, superannuation funds may be restricted from achieving efficient structures.	A broadened CGT roll-over relief regime, better catering for the businesses of superannuation funds, would allow funds the flexibility to undertake a greater range of asset holding reorganisations and bring long-term efficiency benefits to the superannuation system and ultimately to retirement outcomes for Australians.	There is no change in underlying economic ownership in asset reorganisations undertaken by superannuation funds.	In the absence of broadened CGT roll-over relief, superannuation funds may be restricted from achieving efficient outcomes for their members. This less than desirable outcome increases the cost to superannuation funds of managing their investment portfolio, thereby increasing the cost to members.

C. Post-merger rationalisation of structures and realisation of losses

ASFA considers that there is scope to broaden the existing CGT roll-over relief to apply where superannuation funds undertake asset reorganisations in order to realise efficiencies of structures following a merger.

C.1 Introduction

Following a merger of superannuation funds, the trustee of the merged fund (that is, the continuing fund) will generally assess the appropriateness of the structures inherited under the merger. This typically involves assessing the portfolio design, portfolio construction and legal structure of the investments held by the merged fund.

Generally, in order to obtain the full benefit of the merger, efficiencies are obtained by aligning the management, oversight, governance and legal structure of the assets held within the merged portfolio.

For example, a merger may result in a superannuation fund holding certain asset classes (such as private equity) through two separate wholly owned Australian unit trust structures rather than through one trust. Such a structure would be inefficient from an operational perspective as many costs would be doubled in such a structure, for example audit fees, tax agent fees, trustee fees, custodian fees, etc. This is in addition to operational inefficiencies that may arise through such holdings — for example, multiple internal accounts, multiple funding for the same asset class etc.

C.2 Broadened CGT roll-over relief required

The scope of the CGT roll-over relief provisions for mergers is limited to providing tax relief on the tax implications which would occur in the hands of the superannuation fund on the SFT.

The rules do not extend to changes to the funds' investment structures occurring on or around the time of a merger. There is no CGT roll-over relief to enable the rationalisation of such structures to create greater (non-tax) operational efficiencies. As such, the tax impediments of bringing forward the tax consequences on unrealised positions in order to achieve structural efficiencies may be significant.

Without appropriate CGT relief, trustees of merged superannuation funds are often left to maintain inefficient structures, thereby increasing the cost to members, due to the tax impediments which may arise on the rationalisation of post-merger structures.

C.3 Broadened loss roll-over relief required

The Loss Relief for Merging Superannuation Funds provisions contained in Division 310 enable merging superannuation funds which have either revenue or net CGT losses to be rolled over to the continuing fund, thereby preserving the value of these losses within the members' account balances.

However, in the event that there are unused revenue losses 'trapped' in Australian unit trusts which are at least owned 50 per cent by the closing fund, such losses will be extinguished on the merger of the superannuation funds as the 50 per cent stakeholder test in Schedule 2F will be failed. There can be a wide variety of situations where revenue losses may exist in an Australian unit trust, including losses arising from TOFA Assets, various derivatives, and foreign currency, net rental losses arising in trusts holding real property, and net partnership losses in trusts formed to hold some types of foreign investments. They may also be present during the early stages of an investment.

In some circumstances, extinguishing tax losses within Australian unit trusts may be a barrier to a superannuation fund merger occurring and the merger does not proceed due to the quantum of losses at stake.

D. Reorganisation of assets (outside of a merger)

Prior to the introduction of the tax consolidation rules, corporate groups had rollover rules that allowed for the transfer of assets between groups without crystallising tax consequences. The tax consolidation provisions now allow this to happen within a tax consolidated group. By way of contrast, superannuation funds cannot be a head company, nor are there rollover rules in place to allow for the transfer of assets involving the fund and its wholly owned entities. These rules evolved at a time when superannuation funds had fairly 'vanilla' asset holding structures.

ASFA considers that there is now scope to broaden the existing CGT roll-over relief to apply where superannuation funds undertake asset reorganisations in order to achieve flexibility and efficiency in their business activities, in situations not involving a merger.

D.1 Introduction

Member savings in superannuation have grown substantially over the past decade, with total superannuation assets of approximately $2.7 trillion as at 31 March 2020[4], compared to $1.03 trillion as at 30 June 2010[5]. Superannuation assets are also forecast to continue to grow quite significantly over the next 10 years.

Superannuation funds therefore continue to invest greater amounts and continue to seek diversity of assets, and in doing so continue to accumulate a broad range of assets. These may extend to direct assets, for example, investments in discrete property or infrastructure assets which may be located either onshore or offshore. It is noted that significant direct assets are often necessarily held by superannuation funds via a separate legal entity (a special purpose vehicle, or 'SPV') principally to achieve separation from the superannuation fund for legal and regulatory reasons, and to protect the other assets and the interests of members in the superannuation fund.

Superannuation funds also continue to broaden their member offering and experience the need to respond to an increasingly sophisticated membership which influences the manner in which superannuation product and investment offerings are tailored to the preferences of particular groups of members.

D.2 Drivers for superannuation asset reorganisations

As significant long-term investors, superannuation funds will continue to acquire and accumulate assets that are held over a very long horizon. It can be anticipated that long term investments could be held for anywhere between 10 and 15 years or in some cases even much longer. This presents superannuation funds with the need to undertake reorganisations of their asset holdings from time to time, whether that be due to changes in law (being commercial, tax and regulatory) or changes in the fund offerings to members (being investment options and choices) over that period, to ensure those assets continue to be held in an efficient and appropriate manner for the circumstances. This may be to ensure ongoing efficiency, whether for cost efficiency including that of compliance costs, or to maintain global tax efficiency or to satisfy specific risk management objectives.

The need for superannuation funds to reorganise assets over time may also arise from broader commercial requirements which may be driven for example by a greater participation in asset acquisitions with consortium investment partners, or development of other sophisticated co-investment management relationships, which brings greater need for flexibility in dealing with significant assets over a long horizon.

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[4] APRA, Quarterly superannuation performance statistics, March 2020

[5] APRA, Annual Superannuation Bulletin June 2019, table 4a

The need may also arise through demand from superannuation fund members. As funds offer increased choice in investment allocations to their members, the need to support member investment preferences with particular investment exposures may over the long term present the need for the reorganisation of relevant significant assets, for example either into or out of investment holding platforms.

D.3 Broadened CGT roll-over relief required

The present CGT roll-over relief regime is quite limited in its application to the businesses of superannuation funds and is instead focused towards the provision of CGT roll-over relief to companies and corporate groups undertaking asset holding restructures.

Superannuation funds are therefore currently limited in their ability to undertake asset reorganisations without unduly bringing forward the CGT liability that would otherwise only be payable at a later time (that is, when the assets are sold to a third party), including in circumstances where there is no change in underlying economic ownership of the assets in the reorganisation.

Some example scenarios where this may occur in the context of superannuation funds are included in **Appendix B**. The Board will note from Appendix B the particular relevance of the present limited operation of Division 126-G as it relates to transfers of assets involving unit trusts.

ASFA is therefore concerned that superannuation funds will hold or accumulate inefficient investment holdings which will ultimately produce increasing inefficiencies in the delivery of superannuation benefits to fund members.

ASFA considers that there is no policy reason the relief should not also be extended to the investment operations of superannuation funds. We anticipate that the roll-over relief regime has historically not been broadened to cater for the businesses of superannuation funds either because — at the time particular relief measures were introduced for other entities — funds were not taxable entities or were smaller, less complex organisations with less practical need for application of the relief.

ASFA submits that a broadened CGT roll-over relief regime better catering for the businesses of superannuation funds would allow funds the flexibility to undertake a greater range of asset holding reorganisations and bring long-term efficiency benefits to the superannuation system and ultimately to fund members.

Appendix A: Suggested improvements to CGT roll-over relief under Division 310 of the ITAA 1997

Division 310 of the ITAA 1997 plays an important role in removing tax impediments which might otherwise hinder consolidation within the superannuation industry, due to two key reasons:

(i) the transfer of assets under a merger or SFT would otherwise trigger CGT events for the original fund, potentially crystallising a large tax liability meaning that the fund has less money invested and generating returns for the benefit of its members; and

(ii) upon a SFT, the original superannuation fund ceases and therefore any unused tax revenue or capital losses are effectively forfeited, with the future tax benefits of the losses potentially being derecognised as an asset of the fund and reducing its net asset value along with member account balances.

This was confirmed by the recent Productivity Commission Inquiry Report *Superannuation: Assessing Efficiency and Competitiveness*, and subsequently accepted by the Government culminating in the recent passage of legislation[6] to make Division 310 tax relief permanent.

In general, Division 310 has served its purposes in facilitating superannuation fund mergers since its introduction more than a decade ago, particularly where assets are held directly by the two merging superannuation funds. However ASFA submits that its operation should be enhanced by simplifying/clarifying certain design features which create compliance complexity, along with extending its application to go beyond large fund to large fund mergers and cover other circumstances which might lead to a more efficient superannuation system.

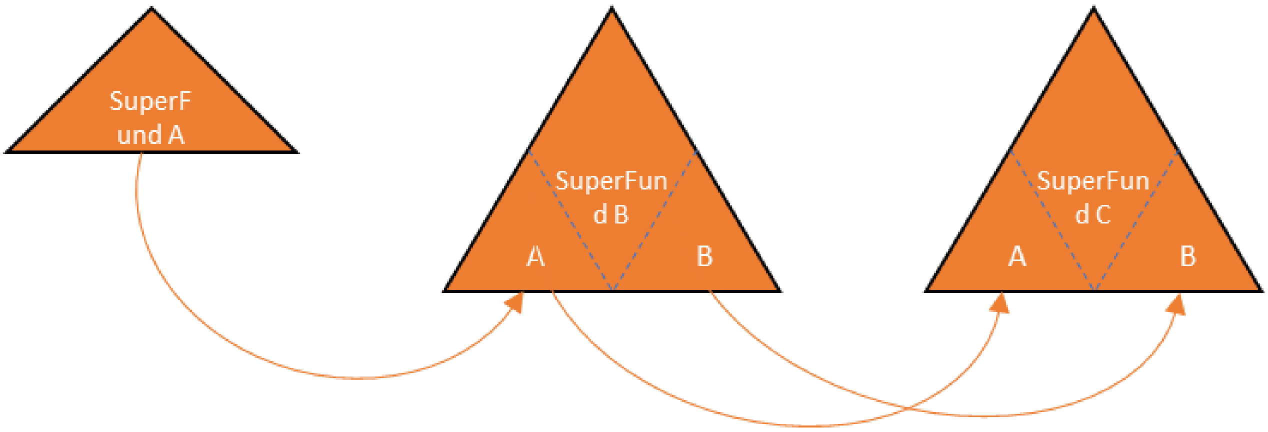
1. Enhancement of circumstances when Division 310 tax relief may be available

1.1 Transfers of sub-plans between large superannuation funds

Division 310 does not cater for scenarios where the members and assets of a sub plan within a large superannuation fund are transferred out to another large superannuation fund. Over the past two decades, a substantial number of employer sponsored funds have ceased to exist as separate superannuation entities, however they have been rolled into other funds and continue to operate as sub-plans within those funds. At the time of drafting Division 310, the further evolution whereby such sub-plans might be rolled out of those funds and into other large funds was understandably not contemplated.

Whilst Division 310 facilitates the initial transfer of members and assets from an employer sponsored fund into a large superannuation fund (becoming a sub-plan of that large fund) it does not provide tax relief for a subsequent transfer. This is illustrated in the following diagram:

[6] *Treasury Laws Amendment (2020 Measures No. 1) Act 2020*



SuperFund A merges into SuperFund B (and becomes Sub-plan A)
Division 310 relief available

Sub-plans A and B are rolled out of SuperFund B and into SuperFund C
Division 310 relief NOT available

The transfer of a sub-plan may be considered desirable by the employer given changed circumstances affecting the value and benefits delivered to members (including fees, returns, insurance and advice) compared to other options in the superannuation market. Large employers will often undertake a tender process to select the target fund for their sub-plan.

The crystallisation of unrealised CGT positions acts as an impediment to efficient decision making by employers in this scenario. In circumstances where both members and assets of a sub-plan are transferred to another large superannuation fund, Division 310 should operate to provide for CGT roll-over relief in respect of those assets. This is submitted to be consistent with the existing Division 310 relief as a form of desirable business reorganisation which allows for changes in underlying economic ownership.

In the context of the Board of Taxation review, this enhancement to Division 310 would align with the policy consideration to reduce the effects of 'asset lock-in'. That is, the absence of CGT roll-over relief may distort decisions as to the allocation of capital in the form of members' retirement savings.

The extension of Division 310 to sub-plan transfers would, to an extent, represent it operating at a product level within a fund. This is analogous to the former Division 311 of the ITAA 1997 which provided temporary CGT roll-over relief to enable reorganisations whereby members and related assets were transferred to a MySuper product in another superannuation fund or within the same superannuation fund. The purpose of the Division 311 relief — to ensure that members did not incur adverse and unintended tax consequences upon a transfer — is equally applicable to sub-plan transfers as described above.

As a final comment in this regard, ASFA would be pleased to provide the Board with suggested drafting for the requested enhancement to Division 310.

1.2 Transfers from SMSFs into large superannuation funds

APRA's superannuation statistics indicate that as at 31 March 2020 there were 596,180 self-managed superannuation funds (SMSFs) holding assets valued at $675.6 billion[7]. SMSFs are clearly an effective structure through which many Australians choose to hold their superannuation.

However, there are circumstances where it may be desirable – or in some cases necessary — for the member-trustees to wind-up a SMSF and transfer into a large superannuation fund. For example:

- the member-trustees of the fund may cease to be Australian residents, such that the SMSF will cease to be an 'Australian superannuation fund'[8] and a 'resident regulated superannuation fund'[9] and, therefore, a complying fund[10] — thus losing the concessional tax treatment afforded to complying funds;
- the health of one or more of the member-trustees may be impacted (an emerging issue which is expected to become more prominent), making it difficult for them to effectively discharge their obligations as trustee; and
- whilst many SMSFs were initially set up with the intention of undertaking the investment management activities, these activities have over time been performed by a third party. With developments in product offerings, these activities can — from both a cost and investment return perspective — now be more efficiently managed within a large fund environment.

If the SMSF has tax revenue and/or capital losses, and/or significant unrealised capital gains which would be crystallised upon it being wound up, tax will act as an impediment to the transfer of the SMSF into a larger superannuation fund, because:

- Division 310 does not cater for the assets of a SMSF to be rolled-over to a large superannuation fund (or indeed the tax revenue and capital losses within a SMSF to be transferred to a large superannuation fund).
- SMSFs are also specifically excluded from the current terms of the Division 310 tax relief (refer to subsection 310-10(1)(a)), noting that they were within scope when Division 310 was first introduced[11].

ASFA submits that the tax law should provide for flexibility for a large fund to receive assets from a SMSF (such as ASX listed shares) under a SFT. The current exclusion of SMSFs from Division 310 tax relief should be removed, to facilitate both the transfer of tax revenue/capital losses and also CGT roll-over.

In ASFA's view, Division 310 should also facilitate tax revenue and capital losses of SMSFs to be transferred to a large superannuation fund under a SFT, as the existence of such losses acts a disincentive to SMSFs being wound up given they would be forfeited at that time.

Again, ASFA submits that this is consistent with the existing Division 310 relief as a form of desirable business reorganisation which allows for changes in underlying economic ownership.

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[7] APRA, Quarterly superannuation performance statistics, March 2020

[8] As defined by subsection 295-95(2) of the *Income Tax Assessment Act 1997*

[9] As defined in subsection (10(1) of the *Superannuation Industry (Supervision) Act 1993* (SIS Act)

[10] As defined in section 42 of the SIS Act

[11] Subsection 310-10(1)(a) as introduced into the *Income Tax Assessment Act 1997* by Schedule 2, item 1 of the *Tax Laws Amendment (2009 Measures No 6) Act 2010*

Furthermore, this enhancement to Division 310 would align with the policy consideration to reduce the effects of 'asset lock-in'. That is, the absence of CGT roll-over relief may distort decisions as to the allocation of capital in the form of a SMSF being maintained where it is not otherwise desirable or efficient.

2. Clarification and simplification of the operation of Division 310 relief

2.1 Timing requirements

For CGT roll-over relief to be available under Division 310, the 'transfer events' in respect of the original fund's CGT assets must all happen in the same income year as the 'completion time', being when the original fund ceases to have any members (refer to subsection 310-45(3) of the ITAA 1997). There are various considerations relevant to determining the timing of a superannuation fund merger, although in many cases the date chosen is either 30 June or 1 July. As most superannuation funds have a 30 June year end for tax purposes, this creates a technical risk that the conditions for assets roll-over may not be met.

Large superannuation funds hold a broad range of assets, and ensuring their contemporaneous transfer can present practical, commercial and legal challenges (for example, other parties exercising pre-emptive rights to them) in circumstances where there is no advantage sought or other form of tax mischief.

Funds undertaking mergers can spend considerable time and effort in managing this timing aspect to quality for Division 310 relief, which is considered unnecessary. Rather, Division 310 should be more flexible as to its timing requirements for the assets roll-over, for example by referring to the SFT completion date pursuant to the SFT Deed which governs, *inter alia*, the transfer of the original fund's members and assets. The requirement might simply be that the SFT completion date determines the income year in which the Division 310 tax relief arises, or even that the relief arises at the point of each asset actually being transferred (with no CGT taken to have happened before hand). Under the current measures, a SFT Deed signed on 30 June for a SFT to occur in the following income year may not be eligible for loss relief for merging superannuation funds under Division 310.

In the context of the assets roll-over, this might be subject to the transfer of assets under the SFT deed occurring as soon as is practicable but no later than 6 months after the SFT completion date (but taking effect for tax purposes on the SFT completion date).

ASFA requests this simplification of what is considered to be unnecessary complexity with the current design of Division 310, with the suggested improvement addressing a current technical 'black letter' requirement that can make navigating the law difficult.

2.2 Identification of applicable CGT event(s)

Further to the timing issue above, the transfer of assets under a SFT may result in a number of CGT events being considered as 'happening', and they may not all have the same timing rules, which adds to the difficulty in navigating the current law.

The Explanatory Memorandum to the amending legislation which introduced Division 310 (the EM) stated at paragraph 2.3 that:

> "The transfer of assets from one superannuation fund to another, under a merger between the two funds, will typically trigger CGT event A1 (about disposals of a CGT asset — section 104-10 of the ITAA 1997) or may trigger CGT event E2 (about transferring a CGT asset to a trust — section 104-60 of the ITAA 1997)."

Furthermore, section 116-110 in the context of capital proceeds upon roll-overs for merging superannuation funds, refers to CGT events A1, C2 or E2.

Whilst the order of application of CGT events is determined pursuant to section 102-25, there is no further guidance in this context where multiple CGT events may happen.

Particularly as between CGT events A1 and E2, depending upon the circumstances there may be a different time for when each event happens (aside from which their consequences should be identical), making it more complex to assess whether the timing requirements for the Division 310 assets roll-over are met.

Following on from the above suggestion regarding the Division 310 timing requirement, a simple further clarification could be that irrespective of whether the applicable CGT event is A1, C2 or E2, the time that the event happens in this context is deemed to be the SFT completion date.

Again, ASFA requests simplification of what is considered to be unnecessary complexity with the current design of Division 310 and related CGT provisions, with the suggested improvement addressing a current technical 'black letter' requirement which can make navigating the law difficult.

2.3 Practical issues with tax record-keeping for CGT acquisition date of assets

The CGT roll-over relief provided under Division 310 broadly does not alter the acquisition date of the continuing fund as being when the assets are transferred pursuant to the SFT. However, solely for the purposes of assessing entitlement to the CGT discount, table item 10 in subsection 115-30(1) treats the continuing fund as having acquired the relevant asset when the original fund acquired it.

Strictly speaking, this means that the continuing fund would be required to maintain two sets of CGT acquisition date records, being:

(i) A default CGT acquisition date at the time of the SFT; and

(ii) Upon a disposal which occurs within 12 months of that SFT, the original fund's acquisition date for the asset for the purposes of CGT discount entitlement.

Practically, however, custodian tax systems do not have this functionality, and a manual override is not viable as the number of asset parcels will commonly be in the thousands if not tens of thousands. Given these constraints, the original fund's CGT records in respect of assets subject to Division 310 CGT roll-over at a parcel level are simply inherited by the continuing fund — that is, both the cost base and the acquisition date. This achieves the equivalent outcome from a CGT discount entitlement perspective.

There may be a resultant risk that the continuing fund has not satisfied its tax record-keeping requirements, and specifically for CGT purposes under subsection 121-20(1) of the ITAA 1997.

ASFA submits that there is no mischief in the CGT law being amended via a special modification within Division 109 such that the continuing fund's CGT acquisition date is taken to be the original fund's acquisition date for the relevant asset.

Again, this is requested in order that Division 310 operates as simply as possible to promote compliance.

2.4 Interaction of CGT roll-over using 'global' approach with specific CGT exemptions

The interaction of Division 310 with various CGT exemptions is somewhat unclear. Superannuation funds commonly hold assets in respect of which specific CGT exemptions may be available, such as life insurance policies, segregated current pension assets and units in pooled superannuation trusts (PSTs).

In respect of investments in life insurance policies and PSTs, the EM clearly suggested that the relevant exemption provision operated, although Division 310 initially only provided for loss transfer relief and it was only from 1 October 2011 that it also provided for CGT roll-over relief. The EM to the legislation which extended and expanded the operation of Division 310 from this date did not make any similar or clarifying comments regarding the operation of CGT exemptions for life insurance policies or PST investments. Furthermore, no mention was made of segregated current pension assets.

This has resulted in confusion in circumstances where a fund chooses to apply the 'global asset approach' for CGT roll-over relief under Division 310 , as to whether this also applies to life insurance policies, PSTs and/or any segregated current pension assets, or whether the normal CGT exemptions apply. This particularly affects the CGT cost base of those assets in the hands of the continuing fund.

In seeking tax advice and / or guidance on this matter from the ATO, including by way of Private Binding Ruling applications, this adds to the complexity of applying Division 310.

This interaction should be clarified within the legislation — that is, it should be made clear that either Division 310 or the CGT exemption provision applies.

Again, ASFA requests simplification of what is considered to be unnecessary complexity with the current design of Division 310 and related CGT provisions. The suggested improvement addresses a current technical issue which can make navigating the law difficult, noting that the practical impact is often minimal where the affected investment remains CGT exempt within the continuing fund.

2.5 Treatment of Controlled Foreign Company investments

The operation of Division 310 for Controlled Foreign Company (CFC) investments is also not clear.

Superannuation funds may hold investments subject to the CFC rules at the time of the SFT, where there is an 'attribution account surplus' reflecting that the fund has been assessed on amounts not received.

Aside from a merger, at the point of disposal of the CFC investment, any remaining attribution account surplus reduces the proceeds taken to be received (refer to section 461 of the *Income Tax Assessment Act 1936*), and so in a CGT context either reduces the capital gain or increases the capital loss which is made by the fund. The purpose of this adjustment is to prevent double taxation.

Upon a merger, however, whilst the CFC investment may be transferred from the original fund to the continuing fund, the attribution account surplus cannot be. The merging funds might otherwise have preferred to apply the global approach under Division 310, however this would lead to a forfeiture of the attribution account surplus.

Rather than the attribution account surplus being forfeited upon a merger, where Division 310 roll-over relief applies to an asset that is a CFC, suggestions would be either that:

- A capital loss arises in the original fund equal to the amount of the surplus; or
- The surplus is transferred to the continuing fund.

Again, this would simplify what is considered to be unnecessary complexity with the current operation of Division 310 for investments in CFCs. The suggested improvement addresses a current technical issue which can make navigating the law difficult — that is, by effectively requiring the merging funds to apply the 'individual asset approach' whereas they would rather simply apply the global assets approach.

Appendix B: Examples of asset reorganisations (outside of a merger)

Example 1: Portfolio management/rationalisation of investments

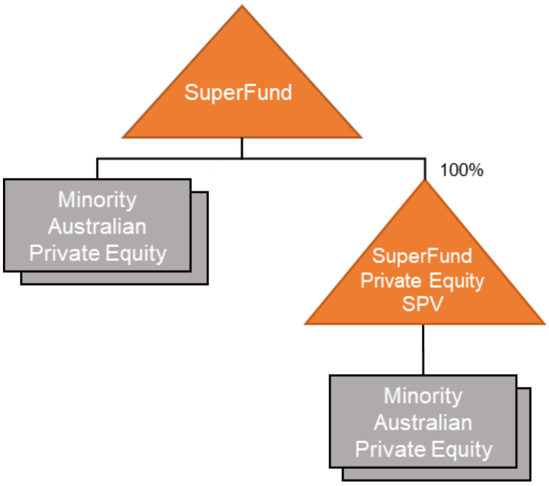
Consider the following examples:

All references to provisions of the tax laws are to the ITAA 1997.

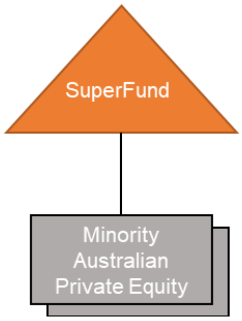
Example 1.1 – rationalisation of investments

Superfund currently holds various private equity investments through an SPV (an Australian unit trust) and also directly by the superannuation fund itself but considers it would be commercially desirable to consolidate the Australian private equity investments.

Existing investment



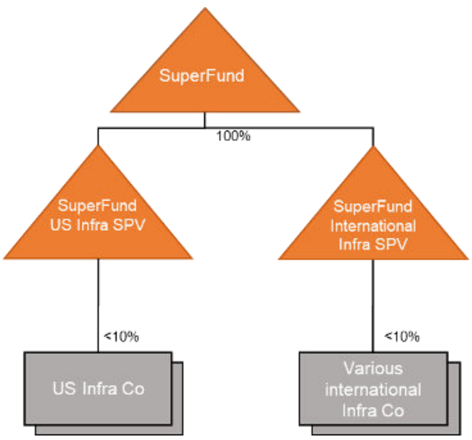
Desired commercial outcome



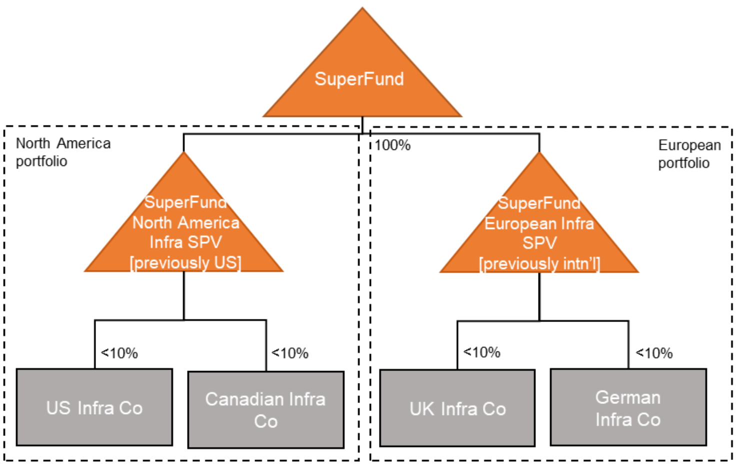
Example 1.2 – creation of portfolios based on regions

Superfund currently holds US infrastructure investments through one SPV and all other infrastructure investments through another SPV but considers it would be commercially desirable to separate the North American assets and the European assets.

Existing investment



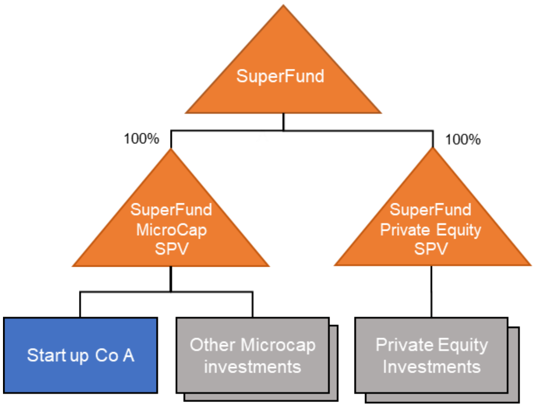
Desired commercial outcome



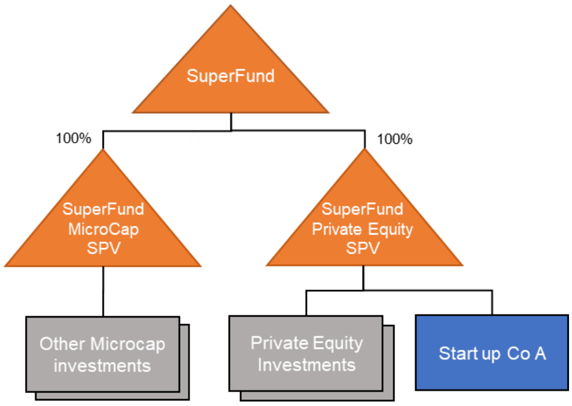
Example 1.3 – changes in underlying investment

Superfund invested in Start-up Co A. Over time Start-up Co A became an established company and no longer fits within Superfund's Micro-Cap portfolio. As such, Superfund wishes to transfer its holdings in Start-up Co A from the Micro-Cap SPV to its Private Equity SPV.

<u>Existing investment</u>



<u>Desired commercial outcome</u>



CGT roll-over is generally not available to superannuation funds in the above three examples due to:

- Restructuring within existing investment entities (generally Australian trusts) would not satisfy the requirements under subdivision 126-G (as section 126-225(b) is not satisfied); and

- Restructuring where an existing investment is held by the Fund itself to an SPV, or held by an SPV to the Fund would also not satisfy the requirements under subdivision 126-G (sections 126-225(c) and 126-230 would not be satisfied)

As such, capital gains will be crystallised if the superannuation fund proceeds with these asset reorganisations notwithstanding there is no change in the economic ownership of the assets.

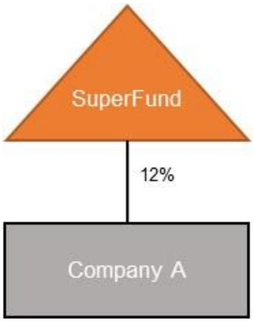
Example 2: Strategic acquisition

Consider a consortium of investors, including Superfund, who together acquired an operating company. Superfund also holds a pre-existing interest in the company.

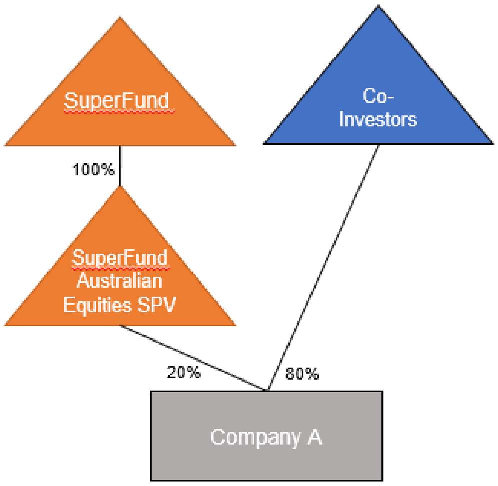
For risk management, legal and commercial purposes, unlisted direct equity investments are generally held by Superfund through special purpose vehicles (SPVs), in this case an Australian Managed Investment Trust.

As a result of the strategic acquisition, Superfund wishes to consolidate its existing shareholding in the company with the additional shares acquired as part of the transaction to reflect the commercial reality of the holding and satisfy its risk management requirements.

Existing investment

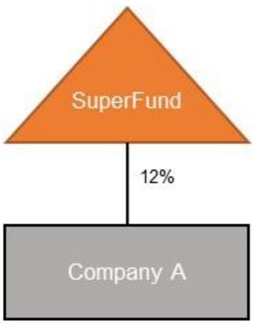


Desired commercial outcome

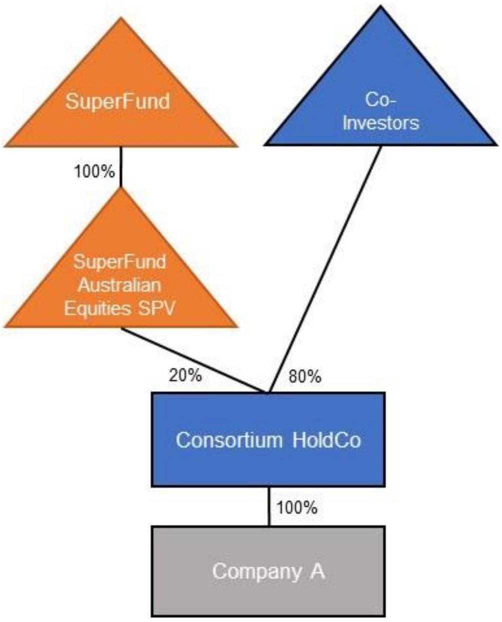


Or alternatively:

Existing investment



Desired commercial outcome



CGT roll-over is generally not available to superannuation funds in the above circumstances due to:

- A contribution of the 12% interest by the superannuation fund to the new SPV will not satisfy the requirements under subdivision 126-G as CGT event E4 is not capable of happening to all of the membership interests in a superannuation fund; and
- Subdivision 124-M requires the same entity to be holding the interest before and after the transaction.

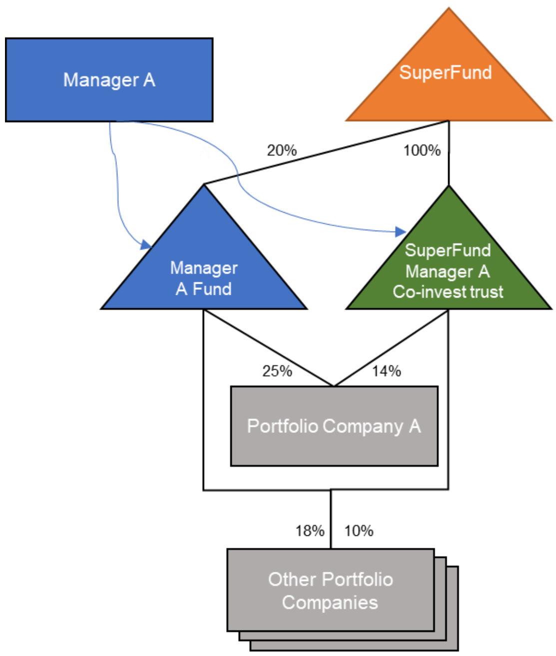
As a result, despite no change to the economic ownership of the existing investment, the superannuation fund must pay an upfront capital gains tax arising from the transfer of its 12% investment in Company A.

Example 3: Long term co-investment

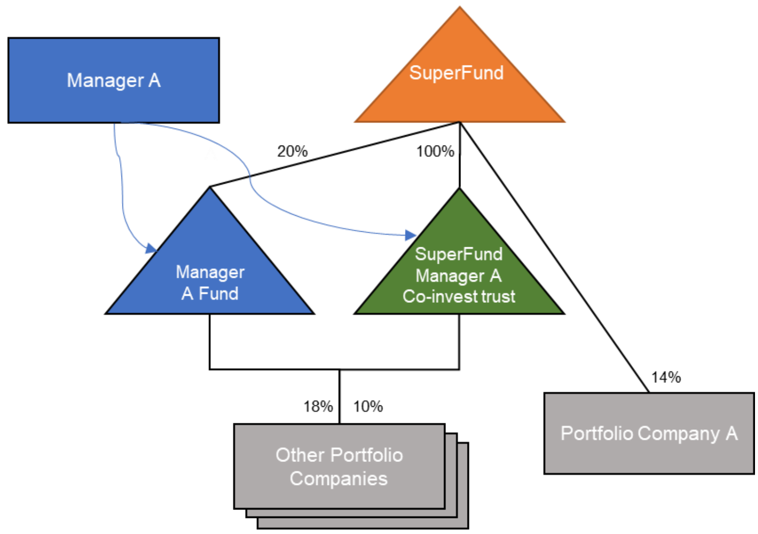
Consider Superfund that co-invests in a number of investments with external investment manager, Manager A. Manager A manages these co-investments through a co-investment vehicle, an Australian Managed Investment Trust, where Superfund is the sole unitholder. Manager A also invests in the same underlying companies (portfolio companies) through its own fund.

Due to a change in investment strategy, Manager A wishes to exit its investment in Company A. Superfund wishes to continue to hold its investment in Company A in the long term.

<u>Existing investment</u>



<u>Desired commercial outcome</u>



An acquisition of the Company A shares held by Co-invest trust by Superfund directly (or by one of its special purpose vehicles) will trigger capital gains tax at the time of transfer, as no CGT roll-over relief is available (for the same reasons noted above in Example 1), notwithstanding that Superfund is the sole beneficial owner of the Co-invest trust that held those shares.