

The Association of Superannuation Funds of Australia Limited
ABN 29 002 786 290
ASFA Secretariat
PO Box 1485, Sydney NSW 2001
p: 02 9264 9300 (1800 812 798 outside Sydney)
f: 02 9264 8824
w: www.superannuation.asn.au



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

Email: cgt_super_roll-over@treasury.gov.au

Dear Sir \ Madam,

CAPITAL GAINS TAX (CGT) ROLLOVER FOR MY SUPER REFORMS

The Association of Superannuation Funds of Australia (ASFA) would like to lodge this submission with respect to Section 2.10 of the Stronger Super information Pack released on 21 September 2011.

The Association of Superannuation Funds of Australia (ASFA) is a non-profit, non-political national organisation whose mission is to advance effective retirement outcomes for members of superannuation funds through research and advocacy. We focus on those issues that affect the entire superannuation industry. Our membership, which includes corporate, public sector, industry and retail superannuation funds as well service providers some of whom deal with self managed superannuation funds (SMSFs), has over 90% of the approximately 12 million Australians with superannuation as members. ASFA members manage or advise on the bulk of the \$1.3 trillion in superannuation assets as at September 2010. ASFA is the only organisation that represents all types of superannuation funds and associated service providers.

In previous submissions to Treasury ASFA has argued that there should be on-going CGT merger relief so that members' account balances are not affected by the merger and the tax benefit of any realised or unrealised capital or revenue losses of the terminating fund can be carried forward in the accounts of the resulting fund.

The underlying policy principle of CGT is that part of a capital gain\capital loss resulting from a taxpayer having disposed of an asset should be treated as income\loss for the financial year in which the asset is sold, transferred or otherwise altered. Effectively, where there is a change in the beneficial ownership of an asset, the CGT provisions operate to treat the disposal of the asset as a taxing point. This policy has integrity in circumstances where a taxpayer has control over the disposal of the asset, including

where superannuation funds dispose of assets in the normal course of investing their funds under management.

At the same time, the CGT provisions recognise that there are circumstances where the taxation of certain disposals is not appropriate and rollover provisions have been introduced to ensure that taxpayers can defer or disregard a capital gain or loss from a CGT event. Examples of events that are considered to be rollover events where certain conditions are satisfied include:

- Disposal of assets to wholly owned companies
- Exchange of shares or units
- Replacement of shares or units with other shares or units, for example where there is a company takeover.

Given the types of CGT merger relief that is currently provided for mergers/restructuring of other entities, ASFA believes that CGT merger relief should be provided on an ongoing basis to superannuation funds. This is particularly the case where fund mergers have been actively encouraged by both the governments and the regulators over the years.

In a superannuation fund merger the beneficial owners (the fund members) generally do not have control over the transaction and post the merger will still retain at least a partial beneficial interest in the assets transferred to the new fund. In some mergers, the transferred members may retain a 100% beneficial interest in the transferred assets. ASFA would argue that special consideration should be given to superannuation fund mergers as any capital gain/loss is not as a result of the final disposal of an asset to a third party who will continue to be a third party post the merger. Rather the third party acquiring the assets will have an ongoing responsibility towards the members, the previous beneficial owners. Where fund mergers occur, the asset transfer is more akin to a change in legal ownership from one trustee to another, due to the ongoing relationship the continuing trustee will have with the transferring members and the transferring members will retain at least a partial interest in the underlying assets.

Notwithstanding our position that CGT merger relief should be ongoing, ASFA contends that where the Government introduces significant regulatory changes that have impacts on the structure of the superannuation industry then it is appropriate that CGT merger relief be provided to enable super funds to make a properly considered decision whether to continue to operate on a standalone basis.

On three previous occasions the Government has sought fit to provide CGT rollover relief, but for limited periods. Two of these periods have related to Government regulatory changes:

- From 12 January 1994 for funds and ADFs amending trust deeds so as to comply with the SIS legislation,

- From 1 July 2004 to 30 June 2006 during the introduction of the RSE licensing regime

ASFA believes that the introduction of the Government's Stronger Super reforms will lead many superannuation funds to consider whether to continue to operate as standalone funds. ASFA would argue that, as with other periods of significant regulatory change, it is appropriate for the Government to provide CGT merger relief through the Stronger Super transition period.

Impact of Stronger Super

The Stronger Super Information Pack states at 2.10 that:

The Government will continue to consult key stakeholders on CGT consequences that may directly arise from transitioning to MySuper and to what extent, if any, CGT rollover relief is appropriate.

ASFA would contend that CGT merger relief needs to be considered, not just in relation to the introduction of MySuper, but in the context of the implementation of the totality of the Government's Stronger Super reforms.

The Assistant Treasurer and Minister for Financial Services and Superannuation notes in the foreword to the Information Pack that the Stronger Super reforms are about providing a better deal for those Australians who choose not to take an active role in managing their superannuation and are also about improving the overall efficiency and integrity of the superannuation system.

ASFA strongly supports the Government's objectives and considers that overall they are in the best long term interest of members of superannuation funds.

The decision for trustees is not merely one of whether or not to introduce a MySuper product. Rather, it is a case of trustees considering the broad scope of the Government's Stronger Super reform and deciding what course of action is in the best interests of the members of their fund.

The introduction of Stronger Super will require superannuation trustees to make a judgment as to whether it is in the interests of members to continue to operate as a stand-alone entity. Trustees need to contemplate and make a decision on:

- Whether or not to introduce a MySuper product;
- The cost implications for the implementation of SuperStream; and
- The improvements to governance and integrity.

ASFA contends that the Government should not consider CGT merger relief merely in the context of MySuper, but in the broader context of the introduction of the raft of Stronger Super reforms.

The following comments are made in respect to the impacts of the various components

of the Government's Stronger Super reforms.

Introduction of a MySuper product

The decision by a super fund on whether or not to introduce a MySuper product hinges on whether or not a fund currently is, and wishes to continue to be, a default fund for contributing employers. The introduction of MySuper will change the competitive dynamics of the superannuation industry. Superannuation fund trustees will make a judgment as to whether their particular fund is likely to have the scale and efficiency to compete effectively in this new environment. The factors that the fund trustee will consider in answering the scale and efficiency question will differ on a fund to fund basis.

Factors that trustees are likely to consider will include:

- The cost of introducing new technology in order to offer a MySuper product.
- The perceived impact of the proposed auto-consolidation rules on fund scale
- The cost of increased compliance

For a superannuation fund, transitioning to MySuper may occur in multiple ways. At its simplest level the transitioning may be by way of re-labeling an existing default fund as a MySuper product. Alternatively, the transitioning may be by way of creating a new MySuper product, or by merging with another fund to either create, or take advantage of, scale such that the financial impact of the transitioning is spread across a greater number of members.

SuperStream implementation

SuperStream will require all funds to undertake an investment in information technology. The scope of that investment will vary between funds and for some funds it will be considerable. Rather than determine their own processes for receiving contributions and processing rollovers, funds will be required to process these transactions electronically and in accordance with mandated standards that cover not only the data to be moved, but the method by which the data is to be moved. There will also be changes in the scope and method of delivering data to APRA and the ATO. These changes are beyond those required to introduce a MySuper product and may result in a need for considerable expenditure of both a capital and ongoing nature.

Whilst strongly supporting the SuperStream initiatives, ASFA has long held the view that to reap the long term rewards from SuperStream would require an increase in expenditure in the short term by fund trustees and administrators.

Improvements to governance and integrity

The Government's Stronger Super reforms will introduce new governance arrangements that will heighten the obligations of trustees to prudently manage a fund's assets.

Among the flagged changes is a requirement for trustees to exercise a standard of care, skill and diligence of that of a prudent person of business when carrying out their trustee duties. The Government intends to require trustees to develop and document a strategy

for managing and maintaining financial resources for operational risk, in addition to documenting the fund's overall reserving strategy as required under s. 52(2)(g) of the Superannuation Industry Supervision Act.

Trustees of superannuation funds will make an assessment of the cost of implementing the Government's governance reforms in the context of an overall assessment on how the Stronger Super reforms impact on the ability of a fund to compete in the long term.

The case for CGT rollover relief

A key consideration for superannuation funds in making a decision to remain a stand-alone entity is the financial impact on members of the loss of the value of the Deferred Tax Assets of the fund should the fund decide that a merger is the appropriate course of action. As such a loss represents a real economic cost to the members it may prove to be an impediment to merger significant enough to result in trustees deciding against a merger.

As Treasury and the Government have previously been advised by ASFA, many superannuation funds continue to carry forward significant levels of realised and unrealised losses for CGT purposes due to the current economic climate.

ASFA is able to provide information on a confidential basis on mergers that are known to be proceeding. ASFA is also aware of other confidential negotiations which are proceeding where the presence of significant Deferred Tax Assets has the potential to halt the merger.

From our confidential discussions, super funds are currently carrying Deferred Tax Assets equivalent to between 1-3% of member account balances. The level of Deferred Tax Assets is fluctuating due to the continued volatility of global investment markets.

A superannuation fund trustee's interpretation of their fiduciary duties means that a trustee is unlikely to complete a merger where it would result in a significant loss to members.

In assessing whether or not to merge, trustees will balance the loss of DTA assets against the costs that a fund would need to incur in order to address the Stronger Super reforms.

There may be situations where a fund does make a decision to merge, even where it is carrying significant DTA. Such a merger would be on the basis that the fund would have incurred costs as a result of the Stronger Super reforms and the impact of these outweighs the benefit of protecting the DTA.

If CGT relief is not provided, the Government will need to adjust its estimate of the benefits that the Stronger Super reforms will provide to superannuation fund members.

Our reasoning is that where a fund after assessing the impacts of Stronger Super makes a decision to merge, but in the absence of CGT relief, makes a decision not to proceed with a merger due to assessing the negative impact on member benefits caused by the

loss of the CGT deferred tax assets, then the overall benefits of the Government's Stronger Super reforms are reduced. Should the Government not provide CGT rollover relief then it is ASFA's view that the Government should factor these costs into its analysis of the overall benefits to superannuation members of the Stronger Super reforms.

On the basis that superannuation funds with significant DTAs will delay any decision to merge until CGT losses have been offset against CGT gains, ASFA considers that a Government decision to provide CGT loss rollover relief will have a negligible revenue impact for the Federal Government.

An additional factor that trustees need to consider in making a decision to merge in the absence of CGT merger relief is that a fund's ability to quantify the benefits of a merger is constrained by the volatility of investment markets. In the absence of relief a trustee is exposed to movements in markets that can increase, or decrease DTA up until the day that a merger is executed. It is quite possible that a fund could need to defer a merger on the day before it was formally executed if there was a significant movement in markets.

The continued volatility in equity markets and concerns over the global economy has created a situation where it is highly unlikely that in the short to medium term CGT losses will be quickly offset by capital gains. The continued volatility of markets means that, in the absence of CGT merger relief, trustees need to factor in additional risks in considering whether a merger is in the best interest of members.

ASFA considers that it is in the best interest of fund members and of the implementation of Government Policy that consideration of the impact of loss of a CGT deferred tax asset be removed from the decision making process surrounding the implementation of the Stronger Super reforms.

ASFA also notes that even if the current investment performances reverse the DTAs in the short term so that funds have unrealised gains rather than losses, a merger would trigger the taxation of those unrealised gains requiring an outflow of cash to pay the relevant tax. This also has a negative impact on members due to the lost benefit of compounding investment returns. ASFA believes that CGT rollover relief should be provided regardless of the market conditions where legislative reforms are occurring.

Timing and Period of Relief

Due to the limited time for transitioning to MySuper, trustees need to commence their deliberations now, even though much of the MySuper detail is still unknown. This will necessitate the incurring of MySuper development costs even though the trustee may want to merge the fund and will do so if there is rollover relief. The reality is that remaining as a non-MySuper fund is not an option for any fund. The need to avoid the incurring of what ultimately may be unnecessary expenses, increases the imperative for an early Government announcement of CGT rollover relief.

ASFA strongly recommends that the Government make an early decision that CGT loss rollover relief will be provided to funds that merge during the early stages of the implementation of the Stronger Super reforms. The announcement by the Government of its intention to provide relief would assist trustees who are now actively considering whether or not to merge. An early announcement is imperative now that there is more certainty over the proposed timeframe for implementation of the various aspects of the Stronger Super reforms and because many funds have begun to incur implementation costs associated with the Stronger Super changes.

Notwithstanding our view that relief should be made permanent, ASFA considers that it would be appropriate to grant relief to funds that complete the merger process between 1 July 2012 and 30 June 2015 inclusive.

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If you have any queries or comments regarding the contents of our submission, please contact our Principal Policy Adviser, Robert Hodge, on (02) 8079 0806 or by email to rhodge@superannuation.asn.au .

Yours sincerely



David Graus
General Manager, Policy and Industry Practice