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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 General Manager,

TAXATION RELIEF TO SUPPORT THE IMPLEMENTATION OF STRONGER SUPER

The Association of Superannuation Funds of Australia (ASFA) would like to provide this submission with respect to the above May 2012 proposals paper.

About ASFA

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. We focus on the issues that affect the entire superannuation industry. Our membership, which includes corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds and small APRA funds through its service provider membership, represent over 90% of the 12 million Australians with superannuation.

General comments

ASFA is pleased that the Government has recognised the importance of providing relief.

While noting the 1 June 2012 commencement date, we are disappointed that the commencement date was not set to 30 September 2011, the expiry date of the previous loss relief that had commenced on 24 December 2008. Members of superannuation funds who merged between 1 October 2011 and 31 May 2012 and who have suffered a diminution in their benefits due to the unavailability of CGT loss rollover relief may rightly feel aggrieved.

ASFA considers that there will be a need for relief beyond 1 July 2017 for both mergers and mandatory transfers of members where a fund ceases to offer a MySuper product.

ASFA questions the lack of relief for an SMSF merging with an APRA regulated fund and seeks confirmation that the relief extends to Small APRA Funds. Whilst recognising that SMSFs are not subject to the MySuper measures, ASFA is concerned that the absence of tax relief may unnecessarily lock SMSF members into arrangements which have become inefficient or where the trustee is no longer able to properly perform their duties. In particular, it would not appear to

be in anyone's interests that an SMSF presently sitting on realised and unrealised capital losses (which is a very common situation) is impeded from winding up and transferring to a larger fund whilst their trustee awaits better market conditions so as to first recoup these losses solely due to the absence of rollover relief.

Specific comments

ASFA has identified three specific areas of the proposals paper for detailed comment and also a group of successor fund transfer issues that warrant consideration at this time:

1. Section 4.1.3 Certain realised losses will not be able to be transferred

Section 4.1.3 is described as an integrity provision. We understand that the purpose of the integrity measure is to ensure that the receiving fund is not in a better position as regards the individual assets of the closing fund than the closing fund would have been had the merger not proceeded. In essence it appears intended to prevent the crystallisation of a loss on a 'transferred' asset and thus to deny the receiving entity the opportunity to access a capital loss at an earlier point in time than may have been available to the closing entity.

In many mergers, there are sound reasons why the ongoing entity wishes to acquire all assets at market value, and thus, that only a net realised loss is transferred to it from the closing entity. These reasons include absence of secondary markets for some assets (where sales and re-acquisitions on market are thus impractical), legal restrictions on the ability to transfer some types of assets as anything other than disposals, internal governance requirements, and administrative difficulties in identifying (prior to merger date) those assets to be treated as disposals and those to be treated as rolled over.

For this reason ASFA submits that it should be possible for successor funds to treat all assets acquired from other funds pursuant to successor fund transfers as acquisitions at the market value of the asset at the date of transfer.

ASFA also submits that, in practice, the need for the proposed integrity measure may be overstated. Whilst the "total disposal" approach may result in realised losses being brought forward, the extent of existing realised losses in ongoing entities (which are typically much larger entities) are such that the timeframe for recoupment of losses is unlikely to be affected to any material extent.

As an alternative, and as a minimum modification to the proposed integrity measure, ASFA proposes that the integrity measure should not apply where all of the closing fund's assets are sold to the merger fund on the merger date irrespective of whether the closing fund's unrealised position in relation to CGT assets immediately before the merger is a net unrealised capital gain or loss We note that one consequence of allowing prior year realised losses to be transferred while also allowing individual assets to be rolled over, especially if some individual assets have unrealised gains, could be to permit a larger loss to be transferred than intended. Please refer to the detailed comments in section 4.3.1 below.

As a general principle of trust law, a transferor fund trustee must assign an appropriate market value to any disposals. Should Treasury be concerned about any manipulation of values, there are other existing remedies available to address that particular problem.

ASFA understands that the difficult market value calculations will be in those cases where the transferor holds distressed or frozen assets that are incapable of being sold to a third party other than at an extreme discount. Such a disposal would not be in the best interests of members. We propose that the only practical remedy to this situation is to permit the transferee to purchase those distressed assets at a more realistic value and transfer the realised loss, if the parties so desire.

2. Section 4.1.6 Choosing the form of the asset-roll-over

This section of the proposals paper proposes that for CGT assets there will be the typical optional CGT asset roll-over for capital gains and capital losses but for revenue assets, where the transferring entity is in a net unrealised gain position the transferring entity must adopt the individual approach (i.e. treating all assets with unrealised revenue gains as disposals, and all assets with unrealised revenue losses as asset rollovers). ASFA submits that such a requirement may give rise to insurmountable practical difficulties for some closing funds and their custodians. For this reason, ASFA submits that the proposal to allow the global approach in relation to CGT assets be extended to revenue assets.

3. Section 4.2 Taxation relief to facilitate the mandatory requirements to transfer members and assets to a fund that offers a MySuper product

Under the MySuper proposals, a fund that does not offer a MySuper offering to its default, or non-choice, members will be required to transfer those members and their benefits to a fund that does offer a MySuper product. This section proposes optional CGT rollover for capital gains and capital losses with respect to such transfers. It also proposes optional loss relief to permit the transfer of losses sufficient to reflect the value of losses incorporated in members' account balances.

ASFA is concerned at the time limit on the operation of the relief and the lack of clarity as to the circumstances in which relief will be available.

ASFA is also concerned that the compulsory transfer of these default members will have a detrimental effect on their balances.

4. Other successor fund transfer issues

The proposed MySuper reforms and the compulsory transfer of members through fund mergers may adversely impact on members in a number of ways. ASFA considers that to minimise the impact of this activity on members, the following matters which are each specifically related to successor fund transfers should be considered and dealt with in finalising the legislation:

- Exclusion of such transfers from the "qualified person" requirements/ 45 day holding period rule for franking credits
- Classification of a transfer of members benefits under these circumstances as not being a superannuation benefit payment
- Permitting access to No-TFN contribution offsets (Section 295-675 of the ITAA 1997)
- Permitting access to blackhole expenditure deductions
- Addressing the impact of Stamp duty on asset transfers

More detailed comments on each of the above four topics is set out on the following pages.

Section 4.1.3 certain realised losses will not be able to be transferred

Under the previous relief, there were two general methods available for moving assets from the closing entity to the ongoing entity. The first was to utilise the asset rollover. Under this method the original CGT cost base is retained and any unrealised capital gain or loss in the closing entity at merger date becomes an unrealised capital gain or loss in the ongoing entity. The second method was for the closing entity to dispose of the asset, and the ongoing entity to acquire the asset at market value on the date of the merger. This resulted in any then unrealised capital gain or loss becoming a realised capital gain or loss in the closing entity. If this resulted in a realised capital loss, this was added to any existing realised capital loss and the total was transferred to the ongoing entity by utilising the loss rollover. If this resulted in a realised capital gain, this was netted against any existing realised capital loss and again the total was transferred to the ongoing entity by utilising the loss rollover. In both cases, the ongoing entity treated the acquired assets as having been acquired on the merger date at their then market value.

Under the proposed new relief, if the total disposal approach is adopted and the unrealised position on any asset at merger date is an unrealised loss, the integrity provision as described in section 4.1.3 of the proposals paper would result in the closing fund being unable to transfer this now realised loss to the successor fund. This would effectively mean that funds are unable to adopt the "total disposal" approach commonly used by many funds under the previous relief.

ASFA submits that whilst there may be policy reasons for the closing fund being unable to transfer this realised loss (or the ongoing fund to obtain access to it at an earlier point in time than may have been the case for the closing fund), there are other factors that also must be considered, including:

- The absence of a secondary market for some assets, such that the option in the proposals paper of selling the asset and re-acquiring the asset on market may not be possible;
- A legal requirement for certain types of assets to be sold, ie, where it is not permissible for owners of particular types of assets to "rollover" these assets; and
- Significant administrative difficulties in identifying those assets on which a capital loss would be realised on disposal (this is simple in hindsight, but due to market fluctuations is extremely difficult in the period immediately prior to merger, and thus presents great difficulties to funds which may need to instruct their custodians in advance which assets are "sold" versus "rolled").

In practice, the level of existing realised losses in the ongoing fund (which is usually a larger entity than the closing fund) are significant, and the larger combined fund creates a larger base of assets on which capital gains may accrue in future to recoup existing capital losses. The combination of these two factors means that the timeframe in which the ongoing fund will recoup capital losses, and thus recommence paying tax on capital gains, is unlikely to be affected to any significant extent by the bringing forward of the unrealised capital losses in the closing fund.

For all of these reasons, ASFA considers that it should remain possible for the "total disposal" approach to be adopted in mergers under the new relief, i.e. for the merger to be effected by the full disposal of all assets at market value by the closing fund, and acquisition at market value by the ongoing fund.

The acquisition of all assets at market value from the closing fund would achieve the following objectives:

- It would better support the ongoing fund's tax governance procedures and risk management processes. Where there is any uncertainty about the tax governance arrangements of the closing fund, the ongoing fund may prefer to manage this risk by acquiring all assets at market value, thus rendering the closing funds records as only relevant to the closing fund's past tax affairs (including the closing fund's final tax return).
- In relation to many custodians' records, the disposal at market value by the closing fund and the acquisition by the successor fund of the assets at market value is significantly simpler to administer (and to perform checks and reconciliations post-merger). This again enables the ongoing fund to better implement the merger from a governance perspective.
- Importantly, for certain assets, performing an off market transfer at market value greatly reduces the administration costs (including the buy sell spreads) associated with the transfer and hence will allow the Trustee to preserve the members' account balances post the transfer. Based on research of a number of managed fund providers, the buy sell spreads are estimated to be approximately 0.50% of the market value of the asset.

ASFA also submits that, in practice, the proposed integrity measure which would deny the closing fund the capacity to transfer any resultant capital loss on transfers to the successor fund at market value is not required. This is because, in relation to CGT assets, the most common position within superannuation funds at present is:

- Large realised capital losses; offset in part by
- Net unrealised capital gain.

Advice that ASFA has received is that few if any superannuation funds are in a net unrealised capital loss position.

In these circumstances, the proposed integrity measure would not appear to be required and indeed its presence is likely to increase the immediately available capital losses to the successor fund as demonstrated by the following example.

> **Example**
> Fund A is considering a successor fund transfer with Fund B
>
> Fund A has:
>
> Realised capital losses of $100 million, and
>
> Net unrealised capital gains of $40 million (made up of $80 million of unrealised capital gains and $40 million of unrealised capital losses).
>
> As set out in the proposals paper, the closing fund could choose either to:
>
> - Transfer the whole of the $100 million realised capital losses, and elect for the asset rollover for all of the present unrealised CGT assets; or
> - Elect for the asset rollover for the unrealised capital losses of $40 million only, and transfer the net realised capital loss of $20 million arising from offsetting the $80 million unrealised capital gains against the realised capital losses of $100 million.

If the proposed integrity measure was not applied, and Fund A elected to treat all of the transfers as occurring at market value, the resultant net capital loss available for transfer by it to Fund B would be $60 million. This is a typical example of many a fund's present circumstances, and would result in Fund B having immediate access to only $60 million in realised capital losses compared to the $100 million it would have access to if Fund A elected for the asset rollover for all of its assets.

Accordingly, if it is determined that the integrity issue is necessary (notwithstanding the legal and administrative issues noted above), ASFA submits that, as a minimum, the integrity measure should not be applied to capital losses arising on transfers occurring on the merger date itself, if the closing fund's unrealised position in relation to CGT assets immediately before the merger is a net unrealised capital gain. In these circumstances, there is no increase in the realised CGT losses available to the ongoing fund, and therefore the policy objective is not defeated but rather enhanced.

Section 4.1.6 choosing the form of the asset-roll-over

ASFA welcomes the design feature in the proposals paper that the global approach for CGT assets will be available whether or not the closing fund is in an unrealised loss position.

ASFA notes that, in the previous relief, the inability to adopt the global approach for some mergers resulted in significant implementation issues, where extensive liaison was required between the closing fund and its custodian so that the fund could instruct the custodian which assets were required to be treated as "sold" and which as "rolled". The availability of the global approach therefore will represent a significantly lower administrative burden for some mergers.

For equivalent reasons, ASFA submits that the treatment of revenue assets under the relief should also not be subject to the global/individual asset approach for rollover. If the present requirement for individual asset approach is maintained for all funds with net unrealised revenue gains, and the integrity measure applies to make it impossible for funds to alternatively adopt a global "sold" approach (as the losses within any net unrealised revenue gains would then be denied), funds would be left with no alternative but to have to, on an asset by asset and potentially parcel by parcel basis, determine which assets are "sold" and which "rolled". This can be near impossible in the period immediately leading up to a merger, due to ongoing market fluctuations that can shift the position of a revenue asset from being a gain to being a loss or vice versa.

Thus, ASFA submits that the treatment of revenue assets under the relief should not be subject to the global/individual asset approach but rather should be broadly equivalent to that for CGT assets. In particular, ASFA submits that:

- The integrity measure should not be applied to revenue losses arising on transfers occurring on the merger date itself where the closing fund is able to utilise the resultant deduction in its final income tax return, or if the closing fund's unrealised position in relation to revenue assets immediately before the merger is a net unrealised revenue gain; and
- Where a fund elects the asset rollover, the global approach should be available in all cases and not just those cases where the closing fund's unrealised position in relation to revenue assets immediately before the merger is a net unrealised revenue loss.

In addition to its comments above, ASFA submits that both of these design features are required because:

- The risk of significant bringing forward of revenue losses is minimal;
- Otherwise, the closing fund is denied a deduction for a loss that would be available to it if no relief were elected at all; and
- The administrative requirements in adopting the individual approach for revenue assets may be difficult and costly to manage.

Minimal risk of significant bringing forward of revenue losses

As noted earlier, the integrity measure appears directed at disallowing the successor fund access to losses that the closing fund itself would not have become entitled to for a significant period beyond the merger.

In the case, of revenue losses, this risk would not appear significant, as the gains and losses on revenue assets typically accrue over shorter timeframes.

For superannuation funds, section 295-85 of the *Income Tax Assessment Act 1997*, as amended, dictates that CGT is the primary code for calculating gains and losses. Thus, for superannuation funds, the only revenue assets are typically:

- Foreign exchange (FX) instruments; or
- Fixed interest securities.

In the case of FX instruments, these are typically of short duration (three months is usual). Thus, if the closing fund had unrealised FX losses at the date of merger, realisation would occur within the next 3 months anyway, and the closing fund would have had access to the relevant deduction within this short timeframe.

In the case of fixed interest securities, in most large superannuation funds these are now taxed on an accruals basis pursuant to the Taxation of Financial Arrangements (TOFA) rules. As a result, there is likely to be minimal unrealised positions in the closing fund in relation to such securities, and the balancing adjustments pursuant to the TOFA rules are just as likely to be unrealised assessable amounts as unrealised deductions.

The position if there was no relief for revenue assets

Absent any relief for revenue assets, in a merger situation, the closing fund would be required, pursuant to general income tax principles, to adopt a “total disposal” approach, ie, treat the transfers of revenue assets as disposals at their then market value. Any resultant revenue gains or losses would be assessable or deductible respectively to the closing fund.

The closing fund would then claim deduction for any resultant revenue losses against all other assessable income (including taxable contributions). It would be very rare that the closing fund’s final income tax return would result in a tax loss (ie, where some or all of the deduction for these revenue losses was unable to be utilized). This is in contrast to the position for corporate taxpayers, in that most superannuation funds have net assessable income every year, and thus no need for relief to transfer a carried forward revenue loss to a successor fund.

Thus, it can be seen that in relation to most revenue assets, the proposed integrity measure would deny the closing fund deduction for a revenue loss that would have been available if there were no relief at all. This would appear to be a very odd and presumably unintended outcome.

Administrative difficulties and costs

As noted above, the combination of the integrity measure to individual revenue losses, and the individual approach to funds in an overall unrealised revenue loss position, means that neither a "total sold" nor a "total rolled" approach is possible.

Due to market fluctuations, whether a fund is in an overall unrealised revenue loss position may not even be known until very close to merger date (or sometimes not until after merger date, ie, when merger date tax reports are available).

Thus, all funds in an overall unrealised revenue loss position (as well as those funds that are uncertain whether they are in such as position) would be required to:

- Identify all assets with unrealised revenue gains, and treat these as disposals; and
- Identity all assets with unrealised revenue losses, and elect for asset rollover for each of these.

Market valuations change daily, such that revenue assets showing unrealised gains one day may end up resulting in unrealised losses at merger date, and vice versa.

Therefore, the present proposals will be very difficult for closing funds and their custodians to administer. In particular, it will be necessary to obtain a report from the closing fund's custodian as close as practicable to the merger date (but still before that date), showing the unrealised position in relation to every individual revenue asset. The closing fund would then instruct its custodian which assets it is to treat as disposals and which as rolled over. In our experience, some closing fund custodians may only be able to provide reports based on market values up to one month old. In these cases, the closing fund would need to conservatively treat as disposed of any asset on which a gain may possibly accrue (and then be denied, pursuant to the integrity measure, any loss that actually accrues). ASFA submits that this level of complexity (and potential inequity where the result is denial of deduction for losses) is unnecessary and contrary to the underlying policy to provide relief.

Other comments

If the Government determines that the integrity measure is required for revenue assets, and also determines that the individual approach for revenue assets is required where the closing fund is in a net unrealised revenue gain position immediately before the merger, there remains some practical questions beyond the administrative difficulties noted above.

In particular, ASFA submits that the legislation should clarify the meaning of "gain" and "loss" in relation to revenue assets for the purpose of the relief.

For example, it is not clear whether, in the case of fixed interest securities taxed on an accruals basis pursuant to the TOFA rules, the balancing adjustment (i.e. the difference between the original cost of the security plus the TOFA accrual amounts during the period of ownership, and the market value on merger date) is a gain or loss for these purposes. The usual concept of "gain" or "loss" compares cost with market value or sales proceeds, whereas these TOFA

amounts are just the residual part of the overall gain or loss (with most of the gain or loss having been already included in assessable income or claimed as allowable deductions as TOFA accruals).

Similarly, there are other unrealised "revenue" amounts that may appear not to be gains or losses at all – for example, dividends or interest receivable.

ASFA submits that, except in the rarest of circumstances, these issues are simply dealt with by allowing a "total disposal" approach for revenue assets, ie, by not applying the integrity measure to revenue assets.

Section 4.2 Taxation relief to facilitate the mandatory requirements to transfer members and assets to a fund that offers a MySuper product

As we have analysed this section of the proposals paper, more and more issues have arisen. Given that the first of these transfers is some 12 months away ASFA suggests that the opportunity should be taken to apply some deeper thinking to the tax issues related to the compulsory transfer of default members to a MySuper fund.

To begin with, ASFA is concerned at the lack of clarity as to the circumstances in which relief will be available.

Specifically, it is unclear as to whether the relief will be available where:

- A fund loses its authority to offer a MySuper or otherwise ceases to offer a MySuper;
- A member requests to transfer to another fund offering a MySuper rather than the fund chosen as a default by the trustee;
- A fund offers a MySuper but it is not suitable for some default members (or they are ineligible to join it); and/or
- The transferring fund is a small APRA fund

Related to this is the concern that the expiration of the relief on 2 July 2017 ignores the power of the regulator, APRA, to withdraw a MySuper authorisation at any time. This raises the possibility that a compulsory transfer of MySuper members may occur at any time. ASFA considers that such a situation should be contemplated by the proposed legislation.

ASFA has concerns as to the likelihood that the proposed relief will achieve its intended aim. The proposals paper seems to assume that a receiving fund will be comfortable with accepting a transfer value that is made up of real assets, cash and a notional tax asset. ASFA considers that it is more likely that the condition for such transfers would be full payment in cash or tangible assets and that these transfers would only take place where there were a significant number of members likely to be transferred and the transfer amount is commercially attractive for the receiving fund. However, as the trustee will need to treat all members equitably, it may not be possible to transfer the default members to another fund (with the full transfer value paid in cash), where this leaves the remaining members with depleted tangible assets and an increased notional tax asset that may never be realised. Likewise, it may not be possible to transfer some default members on a "tax asset recognised" basis but then to treat other members differently who may have elected to transfer out of the fund on a different basis.

ASFA anticipates that there will be very few, if any, large funds that will not establish a MySuper. If this is the case then the number of forced transfer default members from any given fund will be small and the costs of negotiating the transfer of tax assets may outweigh the value generated.

Where the receiving fund already has significant deferred tax assets ("DTAs") reflecting existing realised and unrealised capital losses, the additional capital losses available to be transferred may be of little value to the receiving fund or it may have a different value in the receiving fund than that at which it may have been recorded in the transferring fund.

A further concern is that the transferrable losses are restricted to the allowance for tax assets that are included in the member's account balance. This could significantly understate the available tax losses that might eventually be used as funds generally adopt a conservative approach in determining the amount of deferred tax assets they recognise in member account balances. Such an outcome would benefit retained members at the expense of transferred default members.

A further concern is that the transferrable losses are restricted to the allowance for DTAs that are included in the member's account balance. This could significantly understate the available tax losses that might eventually be used, as funds may have adopted a conservative approach in determining the amount of DTAs recognised in member account balances. Thus, the proposed restriction would benefit retained members at the expense of transferred default members.

A potential solution may be to reduce the account balance of the default members to remove any DTA component. The trustee could then agree to transfer the reduced account balance together with an unallocated amount representing a proportion of transferring fund's overall DTA. However this may create complications for rollover and contribution purposes.

The proposal appears to be that the optional roll over relief can apply in relation to any tangible assets which are transferred. This may lead to a transfer of a DTA that represents an amount in excess of that included in members' accounts. On the other hand, the optional loss relief seems to be limited to an amount that represents in the value of the DTA in members' accounts. As explained above, this may be a different amount to the full DTA as trustees may have capped the DTA, both for financial statements and in members' balances, for reasons of equity between ongoing and exiting members, or may have a different valuation rate for the DTA to that of the receiving fund. That one form of relief is not capped and the other form is capped raises the question of how the rules will work in combination. This appears to be necessary as where some assets are transferred they must be treated as rolled over assets rather than realising a loss and transferring the loss.

ASFA's conclusion, and concern, on this issue is that despite the proposed relief the compulsory transfer rules are likely to result in a detrimental impact on many members' account balances. Further, trustees are likely to face considerable difficulties in coming up with an appropriate treatment of tax losses.

We are also concerned at the potential cost to trustees as they undertake the process of seeking a fund which is prepared to offer a MySuper and accept the relevant tax losses for transferring members.

Also requiring consideration is the situation of qualifying MySuper members of life insurance companies where those companies propose to not offer a MySuper product. Life insurance companies who do not wish to offer MySuper products may seek an arrangement with a transferee superannuation fund under terms by which:

- Qualifying MySuper members would be transferred from the superannuation fund administered by the life insurance company to the Transferee Superannuation Fund under a Successor Fund Transfer.
- The insurance policies attributable to these members would be transferred to the Transferee Superannuation Fund which may wish to redeem the insurance policies, and invest the proceeds in its investment options.

Within a life company superannuation fund there are generally no losses in respect of investment assets as these losses occur and are recorded at the life company level. As a consequence, any deferred tax assets associated with these losses are also recorded at the life company level and reflected in the pricing of the policies and any gains or losses on redemption of these policies are ignored for tax purposes. It is submitted that the proposed relief should also allow a pro rata portion of the realised and unrealised losses attributable to the MySuper members to be transferred from the Life Insurance Company to the Transferee Superannuation Fund.

Other issues associated with fund mergers

To ensure members are not adversely affected by the proposed MySuper reforms and consequential entity consolidation activity ASFA considers that in finalising the legislation the following matters which are each specifically related to successor fund transfers should also be considered and dealt with:

- *Exclusion from "qualified person" requirements/ 45 day holding period rule*
  ASFA seeks exclusion of merging superannuation entities from the qualified person requirements for the purposes of section 207-145 and section 207-150, ITAA 1997.

  A superannuation entity merger will usually involve the transfer of assets held by the transferring entity to the successor fund. In the case where a share is held by the transferring fund at the point of being ex-dividend, and the related dividend is paid post-merger to the successor fund, the holding period rule ("45 day rule") contained in the qualified person provisions under section 160APHO of the former Part IIIAA, ITAA 1936 may not be satisfied.

  Accordingly, Subdivision 207-F, ITAA 1997 may apply to deny the franking credits on the basis that the superannuation entity is not a qualified person in relation to the dividend received. Note that this assumes that the relevant entities have not made an election to have a franking credit ceiling applied in accordance with section 160APHR, ITAA 1936.

  Therefore we recommend that merging superannuation entities that have not made a ceiling election in accordance with section 160APHR should be relieved from compliance with the 45 day rule for assets transferred as a result of a merger. As an integrity measure, this exclusion could be limited to a specified period of time post-merger.

  As an alternative, the rules could be amended to ensure that the merger is not considered a disposal or an acquisition for the purposes of these rules.

- *Superannuation benefit payments*
  ASFA requests that for the avoidance of doubt, member benefits transferred in the event of a superannuation entity merger be specifically excluded from being Superannuation Benefits for the purposes of section 307-5, ITAA 1997 on the basis that the payments are not paid to the member or at their direction or request.

  On a superannuation fund merger, all assets and members will be transferred to the successor fund. Ideally, all member account balances including all underlying tax component history should also be transferred as if the member had always been a member of the successor fund. This is to ensure that the member is not disadvantaged by the successor fund transfer and to preserve the member's entitlements.

  A transfer of a member's balance to a successor fund may be interpreted under subsection 307-15(2), ITAA 1997 as being a "payment" made for the member's benefit and therefore considered a Superannuation Benefit under section 307-5.

  If the transfer of a benefit under a merger arrangement is to be considered a Superannuation Benefit, a crystallisation calculation of the member's tax components is required. In periods of negative investment returns, the tax-free component can be inadvertently reduced. This may arise when there is no taxable component and accumulated investment earnings are less than the tax-free component of the member's interest. The member can be disadvantaged in this instance as their tax-free component becomes crystallised at the lower amount (reduced by negative investment earnings) yet their future investment earnings in the successor fund will be treated as the taxable component. This clearly results in an unfair outcome for the affected members.

  This is of particular concern in the context of recent market conditions whereby temporary investment losses coinciding with a superannuation entity merger transaction may result in members suffering additional tax when they are paid their benefit.

  A secondary related issue is that a requirement to calculate tax components would impose additional administration upon funds increasing compliance costs. Cost efficiencies arising out of the merger activity such as reduced member administration fees will be adversely impacted which is contrary to the intent of the MySuper reforms generally.

  Therefore, ASFA recommends that the relevant law be amended in a manner that makes clear that benefits transferred under merger arrangements are not captured as Superannuation Benefits.

- *No-TFN contribution offsets (Section 295-675 of the ITAA 1997)*
  No-Tax File Number ("no-TFN") contribution tax arises where a member fails to quote their TFN to the superannuation fund.

  A superannuation fund may be entitled to a tax offset for no-TFN contributions tax if the member later quotes their TFN. However, this entitlement is not transferable if the member changes superannuation funds. That is, having left the fund which deducted the no-TFN contributions tax the member loses all entitlement to reclaim that tax by quoting their TFN to the trustee of their new fund. Whilst recognising the importance to the

integrity of the system of members quoting their TFN, ASFA considers this outcome to be unduly harsh where, as in a successor fund transfer, the member does not initiate the transfer.

ASFA recommends that the law be amended to allow the recipient fund to obtain a no-TFN offset in respect of a member who still has a superannuation interest with the successor fund and subsequently provides that fund with their TFN.

- *Blackhole expenditure*
  Blackhole expenditure was not dealt with in the previous relief legislation under Division 310 of the *Income Tax Assessment Act 1997* ("ITAA97") and has not been discussed as part of this proposal. As this could be a significant deduction for some superannuation funds we recommend implementing a rollover for blackhole expenditure in the event of a merger. This is particularly relevant where merger-related expenses are incurred in the closing fund. Section 40-880 of ITAA97 would allow deduction to the closing fund for such expenses over 5 years, but the closure of the fund results in the loss of any ability for the closing fund to claim up to 80% of such expenses.

- *Stamp duty*
  As the stated Policy outcome of the above proposal is to ensure members are not adversely impacted in the event of a merger or a mandatory transfer under MySuper, we consider it appropriate that the potential stamp duty implications that may arise from these asset transfers be recognised and steps taken to ensure no stamp duty liabilities arise on the transfer. Whilst stamp duty is a State or Territory tax, ASFA submits that the Commonwealth should seek to ensure that each State and Territory implements appropriate relief or exemptions for asset transfers in fund merger situations.

Conclusion
The foreword to the proposals paper states that the proposed relief will:

- Ensure that tax considerations are not an impediment to superannuation funds seeking to merge and consolidate in response to the Stronger Super reforms; and
- Ensure that default members of superannuation funds are not adversely affected if their superannuation benefits and relevant assets are transferred under the MySuper reforms.

ASFA submits that, unless the measures allow the ongoing fund to acquire all assets at market value on the date of transfer (and for the transfer of the resultant net capital loss from the closing fund to the successor fund), there may continue to be impediments to some superannuation funds seeking to merge.

Similarly, ASFA submits that, as the intended purpose of mergers and consolidations is to reduce costs to fund members, the practical difficulties in the application of the individual approach for asset rollover of revenue assets may represent a significant and unwarranted additional cost to some successor fund transfers.

We further submit that some deeper thinking is required around the specific tax issues related to the compulsory transfer of default members to a MySuper fund and to the more general tax issues associated with successor fund transfers.

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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 via e-mail to rhodge@superannuation.asn.au.

Yours sincerely
Margaret Stewart

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