8 June 2012

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

Email: cgt_super_roll-over@treasury.gov.au

Dear Sir/Madam,

Re: Consultation Paper – Taxation relief to support the implementation of Stronger Super

BT Financial Group (BTFG) welcomes the opportunity to provide comments on the Treasury Consultation Paper – Taxation relief to support the implementation of Stronger Super (Consultation Paper).

We believe the Consultation Paper will provide appropriate relief to ensure individual members are not financially disadvantaged by the Capital Gains Tax (CGT) consequences of super funds moving members into MySuper arrangements or merging to seek scale.

However the consultation paper does not address several other taxation consequences which must be addressed for the implementation of Stronger Super.

1. The deemed disposal of assets denies members the benefit of the imputation credits under the 45 day rule

Under the 45 day rule in order to keep the benefits of the imputation credits, the entity needs to have held the assets for 45 days.

> _Example_:
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> Super Fund A buys BHP shares on day 1.
>
> The BHP shares are transferred when Super Fund A is transferred to Super Fund B on day 20.
>
> BHP then makes a distribution on day 50. As the transfer of the BHP shares to Super Fund B resets the start date for the 45 day rule, if Super Fund B sells the BHP shares before day 65 the entity and the members lose the benefits of the imputation credits.

The 45-day rule should be modified to avoid the detriment to members as a result of an asset transfer from the default fund. An amendment is required because the gross up and tax offset treatment does not apply to a recipient of a franked distribution where the recipient is not a 'qualified person' in relation to the distribution for the purposes of section 207-145 and section 207-150 of the Tax Act.

The recently expired Division 310 did not address the 45-day rule in relation to investments that were subject to a transfer. As a result, members suffered the tax consequences by losing entitlement to the imputation credits because the transfer was considered a disposal by the super fund and an acquisition by the receiving fund. Financial detriment occurs even though it is the same members who held the interest in the assets of the super fund both before and after the transfer.

The policy intent for the 45 day rule was for those members who suffered the risk of holding the shares or units only to benefit from the credits. However the denial of relief resulted in members who suffered the risk of holding the shares or units via the fund, ADF, complying super life policy or PST for 45 days being denied the benefit of the imputation credits.

> Recommendation:
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> We recommend the law should be amended so that the transfer of members to a new fund is not classified as a deemed disposal date. An amendment would allow the transferring entity and receiving entity to continue testing the availability of the 45-day rule post the transfer where the underlying assets have been transferred.

2. Refund of no-TFN tax to a member should remain possible after the transfer

Under current tax legislation (subsection 295-675(s) of the Tax Act) only the fund which has paid no-TFN tax for a member can claim a refund of that tax when the member subsequently quotes their TFN.

As a result, where a default member's balance is transferred to a MySuper product and that individual has not yet quoted their TFN, the member will permanently lose the ability to have that tax refunded to their account even where they quote their TFN within the required timeframe.

> *Case study*
> We undertook some successor fund transfers in early 2011. Some of the members transferred previously had no-TFN tax deducted from their account while in the original fund.
>
> To ensure members are not disadvantaged, we made a decision to keep the original super funds open for 4 years to facilitate the refund of this tax to the member once they quoted their TFN.
>
> Keeping the original super fund open solely for the purpose of no-TFN tax refunds is clearly costly and inefficient, but the only viable option for ensuring members are not disadvantaged.

> Recommendation:
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> We recommend that when a member quotes their TFN within the required period, to a fund that they have been transferred to, the no-TFN tax paid by that member should be refunded to the new super fund for crediting to the member's account.

3. Members should not lose the ability to claim a personal tax deduction on personal contributions after a MySuper transfer

Under the current MySuper legislation not all members that need to be transferred to a MySuper product will be current employees of an employer that has established a default arrangement. MySuper legislation will require trustees to move all members in the default investment option into a new MySuper offering. Such a broad definition will include members

who have left an employer but chosen to remain in the same fund or self employed members who have joined a fund and elected to invest in the products default investment option.

Ordinarily a member cannot provide a personal tax deduction notice to a super fund when they have rolled over their superannuation benefit from one fund to another. An exemption to the general rule applies when the member has had their benefit transferred under the Successor Fund Transfer (SFT) provisions (Income Tax Act 1997, section 290-170(5)).

BTFG is concerned that members transferred under the MySuper transitioning rules may not be able to use the same exemption if the transfer is not considered a SFT.

We believe that members should retain the ability to claim a personal tax deduction on personal contributions (where they would otherwise be eligible), when they have been transferred to a replacement fund under either a SFT or a mandated MySuper transition.

Recommendation: BTFG recommends that the Income Tax Act 1997 section 290-170 (5), be updated to ensure that members compulsorily transferred to a new MySuper fund retain the right to claim a personal tax deduction in the new fund.

4. Members may permanently lose any "tax-free component" of their account upon transfer.

If the transfer of a member balance to a MySuper product (under a SFT merger or a MySuper transition) is treated as a rollover of each member's benefit, the application of the proportioning rule (section 307-125 of the Tax Act) will disadvantage members who have experienced negative investment performance since making after-tax contributions to their account. The reason is that the calculation of the "tax-free component" upon rollover means the tax-free component gets 'locked-in' on transfer.

Poor markets over the last few years have reduced member balances, highlighting the significance of the issue. For impacted members, their tax-free amount may be 'locked-in' at a lower level permanently at the time of a transfer. If the member remained in the original superannuation fund the detrimental outcome would not occur.

With respect to the 'locking-in' of the tax-free component, this is likely to affect:

- those members with low level of employer contributions (which would otherwise boost the account balance)
- those members on low incomes who do not make before-tax contributions (not tax effective for low income earners)
- retirees or those nearing retirement who have made large after tax contributions from savings or from the sale of assets.

The majority of the affected members will pay up to an additional 16.5% on the increase in the taxable component caused by the decrease in the tax-free component on transfer to the MySuper product or account consolidation. Given the significant disadvantage produced by this outcome the 'best interests of members' requirement in regard to a transfer to another super fund may not be met. As a result, the transfer may not be possible.

As background, prior to the Simpler Super reforms, successor fund transfers had often been excluded from being treated as a rollover of each member's benefit. However, the revised (Simpler Super) legislation appears to reverse this long held industry practice, and therefore has the potential to permanently disadvantage members by locking in their tax-free

component at a lower level than would otherwise apply. The issue was significant at the time, and continues to be for proposed transfers due to potential inability to meet the ‘best interests’ and ‘equivalence of member’s benefits’ requirements.

Example

Rob opens his BT superannuation fund account by making a non-concessional contribution of $100,000 in 2008, which is allocated to the tax-free component within his superannuation account.

Since then, due to poor performing investment markets, Rob’s superannuation account has experienced negative investment returns.

In February 2011, Rob’s superannuation fund is successor fund transferred to another fund and all the members of the fund (including Rob) are transferred. At the time of the transfer, the balance of Rob’s superannuation account is $80,000.

Assume that Rob chooses to cash his superannuation benefit in November 2012 when the account balance has risen to $110,000.

Approach 1 – transfer was considered a rollover of each member’s benefit: Under this approach Rob’s tax-free component was ‘locked-in’ at the value of his account balance on transfer - which was $80,000. The earnings from that date ($30,000) therefore become a taxable component within Rob’s cashout.

Approach 2 – transfer is not a rollover of each member’s benefit: Under this approach Rob’s tax-free component was not ‘locked-in’ under the successor fund transfer. Instead, his tax-free component is the sum of after-tax contributions and tax-free amounts received into the original and successor funds. This approach is consistent with the outcome if Rob had instead remained in his original superannuation fund to November 2012 – in other words, under this approach, Rob’s tax-free component would not be calculated until November 2012. As a result the trustee would determine the value of the contributions segment which in this case would be $100,000.

The following is a summary of the transactions in Rob’s account under Approach 1 and Approach 2:

	Approach 1	Approach 2
Personal (after tax) contribution	$100,000	$100,000
Rob’s account balance as at date of successor fund transfer (after market have fallen)	$80,000	$80,000
Tax-free component is calculated and “locked-in” for successor fund transfer	$80,000	N/A
Rob’s account balance upon cash-out in November 2012 (after the financial markets rise)	$110,000	$110,000
Tax-free component on withdrawal benefit	$80,000	$100,000

The detriment that arises from applying Approach 1 in the example above, would make it almost certain that the relevant trustee could not form the view that it was in the best interests of members to transfer their benefits to the receiving fund, unless other benefits in the receiving fund outweighed the tax detriment.

As yet we still have no final view from the ATO as to whether successor fund transfers are rollovers, despite the super fund consolidation activity expected as a result of the Stronger Super proposals. The uncertainty places trustees in a difficult position as they must plan for successor fund transfers and mergers not yet knowing whether the 'best interests of members' and 'equivalence of member's benefits' requirements can be met and thus whether the transfer can ultimately proceed.

Recommendation:

We recommend that the transfer of a member balance to another super fund, including a MySuper product, be excluded from the definition of a rollover and consequently the application of the proportioning rule. That is, allow the member's notional maximum tax-free amount in their benefit to carry across to their MySuper account.

We note that a mechanism will be needed whereby details of the notional maximum tax-free amount in their super benefit are reported to the trustee of the new fund on transfer.

We would be happy to meet with Treasury to discuss any of the issues highlighted in our submission.

Yours sincerely

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