24 August 2012

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

by email: cgt_super_roll-over@treasury.gov.au

Dear Christine,

Exposure Draft - Tax Laws Amendment (2012 Measures 2 No. 5) Bill 2012: Merging superannuation funds

The Financial Services Council (*FSC*) welcomes the Exposure Draft legislation and Treasury's continuing support for consolidation in the superannuation industry through the application of rollover relief.

Generally we support the removal of income tax impediments to mergers between complying superannuation funds through reinstatement of Division 310 of the *Income Tax Assessment Act 1997*. We are also pleased that Treasury has accepted element of our previous submission on this issue, dated 8 June 2012, in relation to in-specie transfers and backdating the start date of the measures.

In relation to the Exposure Draft *Tax Laws Amendment (2012 Measures No. 5) Bill 2012* ("Bill") we do however wish to highlight a number of issues that may detrimentally impact tax outcomes and superannuation benefit entitlements of members.

The FSC recommends amendments are made to the Bill to address three main areas, addressed in detail in Annexure 1. These are:

- Rollover relief for MySuper compliance;
- Proper transfer of 'tax losses'; and
- Minor amendments affecting member entitlements.

If you would like to discuss our submission further please do not hesitate to contact Carla Hoorweg, Senior Policy Manager – Global Markets & Tax on (02) 8235 2519.

Yours sincerely

MARTIN CODINA
Director of Policy

Annexure 1

MySuper Issues

The Government's MySuper (Stronger Super) reforms will require superannuation funds to offer a MySuper compliant product by 1 July 2013 for existing members who have not selected a choice of fund. By 1 July 2017 all members who have not selected a choice of fund must have their assets transferred to a MySuper compliant product.

The Proposal Paper specifically addressed the issue of providing rollover relief to facilitate the mandatory requirements to transfer members and assets between superannuation funds due to MySuper reforms, see paragraph 4.2. The reinstatement of Division 310 with amendments in the Exposure Draft does not address this requirement because under MySuper, only 'default' members are required to be moved to a MySuper compliant product. This means that not all members will be transferred.

The Exposure Draft makes no reference to the MySuper reforms and still requires the original superannuation fund to no longer have members, meaning 'default' member transfers between superannuation funds due to MySuper will not be afforded rollover relief.

The Proposal Paper clearly articulated that the rollover relief was to be extended where MySuper was the catalyst. Paragraph 1.10 through to 1.12 of the explanatory memorandum expresses the clear recognition of Treasury that such rollover relief should be provided in the circumstances of MySuper transfers.

The FSC submits that it was the intention of Treasury to ensure that asset transfers between superannuation funds required for MySuper compliance would be afforded rollover relief.

The FSC recommends that amendments be made to ensure that this relief is reflected in the legislation. The amendments required are outlined in the two scenarios below.

1. MySuper – Interfund transfers

Rollover relief of the transfer of default members to a MySuper product which is not the same as that offered by the existing superannuation fund would be required for the following reasons:

- the current superannuation fund is no longer listed as a default superannuation fund under the Fair Work laws and the employer must choose another superannuation fund offering a MySuper product; or
- the MySuper product offered by a different superannuation fund is viewed by the employer as superior to the MySuper product offered by the existing default superannuation fund e.g. lower fees, broader insurance cover, etc; or
- on consolidation of two or more staff funds into one superannuation fund, where both funds currently offer a MySuper product. It is likely the membership would be consolidated into one of the existing superannuation funds, but rollover relief would not be available for those members having to transfer to the other superannuation fund involved.

Example

Large Employer Pty Ltd has over 500 employees and currently uses XYZ super fund as the default fund for its employees.

In August 2013, Large Employer Pty Ltd decides to negotiate with several default superannuation funds, including XYZ superannuation fund, to tailor a MySuper product specifically for its employees. After assessing various super offerings, Large Employer Pty Ltd decides to choose the MySuper product within UVW Superannuation Fund as its default superannuation fund from 1 October 2013.

Employees of Large Employer Pty Ltd have their SG contributions made into UVW MySuper product from that date, however they still have balances in XYZ superannuation fund. These balances cannot be consolidated via transfer to UVW MySuper without incurring capital gains tax.

This is because the proposed rollover relief is not available where the former default fund, XYZ superannuation fund, offers a MySuper product.

Recommendation

The FSC recommends that the rollover relief be extended to include the transfers of assets as part of the transfer of existing default members to any MySuper product regardless of whether a MySuper product is offered by the existing superannuation fund.

2. MySuper – Intra-fund transfers

Investment through a life company or Pooled Superannuation Trust (PST) (referred to as the third scenario in our original submission dated 8 June 2012)

Rollover relief would also be required for transfers of default members to a MySuper product offered within the existing fund that is structured through a life insurance company and/or PST.

Life insurance companies establish segregated asset pools to invest premiums under Master Life Policies which represent the superannuation contributions received from fund members. These assets pools are known as the complying superannuation/FHSA asset class ("VPST class") of the life insurance company.

Many organisations offer multiple products within a single superannuation fund that invest through a life insurance company and/or PST. Further, these same superannuation funds may also offer products that have a direct (i.e. non-policy based) investment structure. Over time investments through life insurance company/PST structures have led to complexities in back office processes and higher administration costs. Many in the industry are now moving towards the direct investment structure in order to reduce these inefficiencies and costs which will ultimately benefit the members in these products.

The FSC considers that this outcome is consistent with the objectives of the Government's Stronger Super reforms.

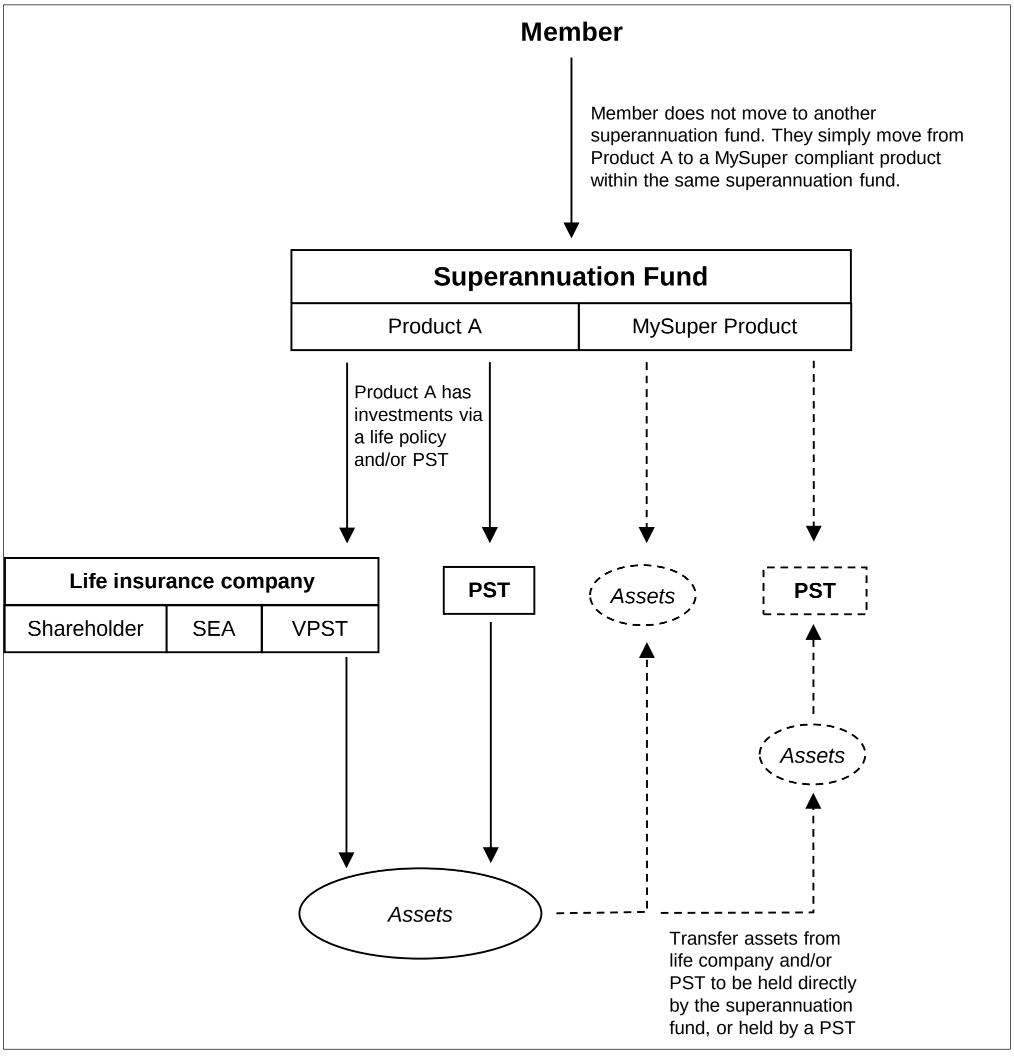
To facilitate this, those superannuation funds that currently invest their assets through a life insurance company/PST may wish to offer a MySuper compliant product that invests assets directly. Whilst default members remain within the same superannuation fund under this scenario, assets would be required to be transferred from the life insurance company/PST to that same superannuation fund. See Diagram A.

<u>Recommendation</u>

The FSC recommends that amendments be made to ensure that the rollover relief explained above and shown in Diagram A, below, is reflected in the legislation.

The objective of MySuper is to provide a product offering that is in the best financial interests of members. In order to do this the FSC believes that the rollover provisions should be drafted to ensure that members are not inadvertently disadvantaged due to the historical investment structure of the superannuation fund.

Diagram A – Scenario 3



Transferring 'tax losses'

Paragraphs 1.23 to 1.31 of the explanatory memorandum outline the intended consequences of choosing to transfer losses. In relation to an earlier year tax loss that is transferred to a receiving entity by a transferring entity, paragraphs 1.30 and 1.31state that "*An amount equal to the transferred loss will be taken to have been made by the receiving entity in the transfer year*" and that "*The receiving entity will therefore be able to <u>utilise the transferred tax losses against income only in the income year that the losses are transferred</u> or in future income years*" (emphasis added). It is noted that the above paragraphs in the explanatory memorandum are consistent with paragraph 4.1.4 of the Proposals Paper.

The FSC submits that section 310-40 and the proposed amendments to subsections 310-410(1)(b)(i) and (ii) (item 7 of the Exposure Draft legislation) will not be able to achieve the above intended policy objective of Treasury.

Division 36 of the ITAA 1997 details how to calculate a tax loss for an income year and how to deduct tax losses. Subsection 36-15(1), which is applicable to entities other than corporate tax entities (such as complying superannuation funds), provides that a "*tax loss for a loss year is deducted in a later income year*". If subsections 310-410(1)(b)(i) and (ii) are to be amended in accordance with item 7 of the Exposure Draft legislation, this means that the transferred tax losses will not be usable in the transfer year, contrary to Treasury's intended policy objective.

The FSC also submits that members will be significantly disadvantaged if the transferred losses are to be deducted from the receiving entity's net exempt income pursuant to subsection 36-15(3). This detrimental tax outcome is a significant obstacle to the superannuation fund merger with another superannuation fund where the original fund has tax losses. It can mean that a trustee will have to decide to abandon indefinitely any merger plans until and unless all the tax losses are used up. This will not be in the long-term interest of members of loss funds.

<u>Recommendation</u>

The FSC recommends amendments be made to section 310-40 appropriately to ensure that transferred tax losses can be used by receiving superannuation funds in the transfer year as well as in future years.

The FSC recommends:
a) the words "*tax loss*" be replaced with the word "*loss*" in the following subsections of the ITAA 1997:

- **310-40(1)(b)(i);**
- **310-40(1)(b)(ii);**
- **310-40(2)(c); and**
- **310-40(2)(d).**

b) a new subsection 310-40(3) that is similar to subsection 707-140(2) be inserted, as follows:

"The receiving entity is not prevented from deducting the loss for the transfer year merely because this Act operates as if the receiving entity had made the loss (to the extent of the transfer) for that year."

Other taxation issues affecting members

Section 290-170 and MySuper Migrations

In the interests of protecting members, the FSC would like to ensure that members migrated under MySuper have the same rights as those migrated under an SFT. In particular, Section 290-170(5) of the Income Tax Assessment act 1997 should be expanded to explicitly include MySuper migrations.

Exclusion from "qualified person" requirements/ 45 day holding period rule

In the interest of protecting members, the FSC submits that merging superannuation entities be excluded 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.

Recommendation

The FSC recommends 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 benefits payments

The FSC submits 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 transactions 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.

<u>Recommendation</u>

The FSC recommends that clarification be provided within the law to ensure 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.

<u>Recommendation</u>

As a recipient fund is not entitled to a tax offset on the no-TFN contribution income, we recommend that the law be amended to allow the recipient fund to obtain a no-TFN offset for a member who still has a superannuation interest with the successor fund and subsequently provides the fund with a valid TFN.

Super Stream – consolidating multiple accounts and reuniting lost super

Lost and unnecessary multiple superannuation accounts can have a significant impact on the retirement savings of individuals concerned and also add to fund administration costs. Currently processes for individuals wishing to consolidate accounts or obtain lost super can be cumbersome.

When members consolidate their multiple accounts within the same superannuation fund, CGT event A1 is triggered, through the buying and selling of assets from the PST, direct investments or both.

Recommendation

We submit that taxation relief should also extent to the consolidation of multiple accounts within the same superannuation fund. The CGT event that occurs should be disregarded as there is no change in beneficial ownership.