



Investment & Financial Services Association Ltd

ABN 82 080 744 163

13 February 2009

Mr Paul McCulloch
General Manager
Business Tax Division
Treasury
Langton Crescent
PARKES ACT 2600

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

Dear Mr McCulloch

Re: Capital Gains Tax (CGT) Roll-over for Complying Superannuation Funds with Capital Losses

The Investment and Financial Services Association (IFSA) welcomes the opportunity to comment on the Treasury Discussion Paper *Capital Gains Tax Roll-Over for Complying Superannuation Funds with Capital Losses*.

IFSA is a national not-for-profit organisation which represents the retail and wholesale funds management, superannuation and life insurance industries. IFSA has over 145 members who are responsible for investing over \$1 trillion on behalf of more than ten million Australians. Members' compliance with IFSA Standards and Guidance Notes ensures the promotion of industry best practice.

A consequence of falling asset prices is that net capital losses may be realised where a merger transaction results in a CGT event. This creates a potential barrier to mergers as the value of these capital losses may be extinguished. As noted in the Discussion Paper, industry consolidation can assist by improving economies of scale and enabling the more efficient provision of services to members.

High priority issues

1. Which superannuation entities are covered?

The Treasury Discussion Paper seems to envisage a simple superannuation fund to superannuation fund merger as the only transaction which would be affected. Not all superannuation is, however, invested in this manner.

IFSA strongly believes that the relief should ensure a level playing field and give companies the maximum amount of flexibility in executing fund mergers.

Mergers involving Pooled Superannuation Trusts

A significant amount of superannuation is invested through Pooled Superannuation Trusts (PST) rather than being directly invested by the superannuation fund. The relief should be flexible enough to accommodate mergers involving a PST. Examples A1 and A2 in **Attachment A** describe two potential fund merger situations involving a PST.

Mergers involving Life Insurance Policies

Prior to the emergence of compulsory superannuation saving, life insurance products were the most appropriate vehicles for retirement savings. As the superannuation market emerged it made sense for a lot of insurance companies to draw on the existing investment capabilities within the life company and invest the superannuation monies via the life company.

Life insurance companies generally use a special purpose superannuation fund to channel superannuation contributions into the virtual pooled superannuation trust (VPST) classes of their statutory funds. The reason this structure is used is that in order for contributions to be tax deductible they need to be made to a superannuation fund not a life company.

a) Mergers out of a VPST

A superannuation fund that holds life insurance policies is not subject to tax upon any profit made on the redemption of those policies: section 118 – 300 and 295 -335 of the *Income Tax Assessment Act 1997* (the ITAA1997). Similarly any loss cannot be offset against other gains. Instead when a member of a fund withdraws money from a superannuation fund ultimately the tax consequences of any profit or loss reside with the VPST of the underlying life company.

Consequently any proposal to merge a superannuation fund that is invested via a life insurance company needs to take into account the tax consequences within the life company itself. The proposed roll-over does not take into account the losses within a life company.

Examples A3 and A4 in **Attachment A** describe two potential fund merger situations involving a merger out of a VPST.

b) Mergers into a VPST

The reverse situation to that in (a) above may also occur, that is, there would be a merger resulting in a transfer of assets from a superannuation fund into a VPST, either directly or indirectly.

Examples A5 and A6 in **Attachment A** describe two potential fund merger situations involving a merger into a VPST. The merger could occur with assets transferred directly to the VPST or indirectly via a transfer to the superannuation fund and a subsequent transfer to a VPST. A description of the merger transaction is also provided for these two examples.

Mergers involving Approved Deposit Funds

Superannuation monies may also be held in an Approved Deposit Fund. This raises the question of whether the rollover extends to the transfer of assets by this class to another superannuation entity.

Recommendation

IFSA recommends that in order for the policy intent to be achieved, the roll-over should be provided to any combination of roll-overs to and from any of the following entities - the VPST class of a life company and the definition of a complying superannuation entity in section 995-1 of the ITAA 1997 (but excluding funds with fewer than five members).

2. Why is this relief only available until 30 June 2010 rather than being open ended?

The Discussion Paper suggests the relief will only be available until 30 June 2010. The need for a robust and efficient superannuation industry will not expire on 1 July 2010. In addition, given the extent of capital losses incurred by some superannuation funds the issue of net capital losses is likely to persist beyond 30 June 2010.

IFSA recommends that the relief should continue indefinitely. Alternatively, IFSA recommends that relief should be available after 1 July 2010 subject to written approval from the Commissioner of Taxation.

3. Does the roll-over extend to realised capital losses brought forward from earlier years or realised capital losses incurred earlier in the year of the merger?

Due to the recent downturn in world markets and a general desire to alter asset allocations to more secure asset classes many superannuation funds have realised capital losses over the last 2 – 3 years.

It seems inequitable to allow the transfer of capital losses in circumstances where a superannuation fund has not yet modified its portfolios and yet deny the transfer where the capital losses have already been realised. Indeed such an outcome would seem to punish those superannuation funds that are properly monitoring and adjusting their portfolios.

Many funds have established a deferred tax asset (DTA) based on realised and unrealised losses, to ensure that the value of tax losses is appropriately reflected in net assets attributable to current members. To limit the roll-over to unrealised losses only inhibits the merger of funds as the proportion of the DTA in the transferor fund supported by realised losses would need to be written off at the time of the transfer. In the absence of an ex-gratia payment by the trustee, the merger is effectively blocked under the *Superannuation Industry (Supervision) Act 1993* as members would be denied equivalent rights.

IFSA therefore recommends that existing unused capital losses should be capable of transfer to the successor fund. In this regard it is noted that most superannuation funds will have made capital gains for years up to and including that ended 30 June 2007. Therefore allowing capital losses already incurred to be transferred would largely be relief for contemporary losses only.

4. Is the roll-over relief limited to full mergers or mergers that occur in a single tranche?

As noted above, the Discussion Paper seems to envisage the simplest of mergers. However with many large superannuation funds it is not possible to transfer the whole fund into another.

For example, a superannuation fund may have both accumulation members and defined benefit members. The intention of the merger may be to only rationalise the accumulation members into a new fund, because the deed does not permit a transfer of the defined benefit members.

There could also be a Corporate Master Trust with multiple sub-plans and/or different classes of members. The intention may be to transfer a sub-plan to another fund.

In other situations a sub-fund may be "contaminated" by an ongoing litigation. The intention may be to transfer the "uncontaminated" part of the membership, but not the sub-fund that has the litigation because it will contaminate the new fund.

In all of these cases, the potential extinguishment of capital losses may prevent the partial successor fund transfer from occurring.

Roll-over should also be applied for a multi-tranche approach to plan transfers. For logistical and risk management purposes, some mergers may be broken down into tranches of plans. Allowing CGT roll-over for mergers so long as they are wholly complete within a certain time frame would ensure that a multi-stage approach can be adopted.

IFSA recommends that roll-over apply flexibly to allow for circumstances where only part of the membership can be transferred and where the transfer occurs in tranches.

Additional issues

5. Many superannuation entities hold interests in financial securities such as bonds. Losses on the sale of such securities are on revenue account. Does the relief extend to revenue losses created as a result of such securities being transferred to a successor fund?

Under subdivision 295 – B of the ITAA1997, CGT is the primary code for calculating capital gains and losses of a superannuation entity. However, under subsections 2 and 3 revenue gains and losses can arise in respect of foreign exchange movements, disposals of bonds, debentures, bills of exchange, deposits and loans.

If a superannuation entity has a portfolio consisting of, for example, 30% fixed interest securities and those securities are in an unrealised loss position then the transfer of those securities to a successor fund should attract a roll-over in a similar manner to the roll-over proposed for assets held on capital account.

IFSA recommends that the simplest form of roll-over in this instance is to allow the successor fund to treat the securities as if they had been acquired at the same cost as that paid by the original entity.

6. For superannuation entities holding infrastructure assets, real property or land rich entities state stamp duty is a significant impediment to mergers. Will the Federal Government be liaising with the State Governments to provide stamp duty relief?

Superannuation funds often hold infrastructure assets, direct property assets or land rich entities. Real estate is an accepted superannuation fund investment and is often used to assist in obtaining diversification. Such assets are subject to stamp duty upon transfer. The top duty rates in the various jurisdictions are currently:

State	NSW	VIC	TAS	QLD	ACT	SA	WA	NT
Rate of duty	5.5%	5.5%	4%	4.5%	6.75%	5.5%	5.4%	5.4%

Such a duty, which is payable by the successor superannuation fund, is a significant impediment to the merger of funds where the original fund has significant real estate holdings. IFSA is aware of mergers that have not proceeded, even without loss roll-over, predominantly because of the stamp duty cost.

IFSA recommends that the Australian Government negotiate complementary stamp duty relief through the Council of Australian Governments.

7. Section 290-170 notices

Under section 290-170(2) of the ITAA 1997, a member will not be able to provide the successor fund with a section 290-170 notice (notice of intend to deduct a contribution) as they will no longer be a member of the fund. A successor fund transfer may therefore make a member worse off by denying them a tax deduction for their personal superannuation contribution.

IFSA recommends that a member who has been rolled into a successor fund and still holds an interest in that fund (within the required time frame) be able to provide a successor fund with a valid section 290-170 notice.

8. No-TFN contributions tax

Under section 295-675 of the ITAA 1997, a fund may be entitled to a tax offset for tax paid on no-TFN contribution income if a member provides their TFN within four years of the tax on no-TFN contribution income being paid to the ATO.

Where a superannuation fund participates in a merger, the law does not allow the successor fund to obtain the tax offset for tax on no-TFN contribution income. A successor fund transfer may therefore make a member worse off by denying them the benefit of a no-TFN tax offset.

IFSA recommends that a member who has been rolled into a successor fund, subsequently quotes their TFN and still holds an interest in that fund be able to obtain the benefit of a no-TFN offset.

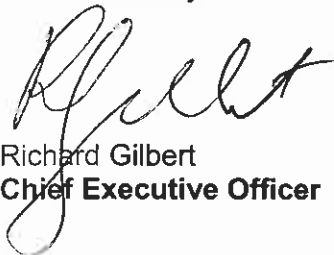
Clarifications

IFSA is also seeking clarification of the following issues relating to the Discussion Paper:

- ***Will the closure of the transferring fund be a requirement to utilise the roll-over?*** Section 3.1 of the Discussion Paper describes the existing law, and states that a transferring fund will generally be wound up following the asset transfer, and the transfer of member accounts to the receiving fund. Often there are legitimate reasons to keep the transferring fund open for a period of time post merger (for example, finalisation of GST claims, lodgement of income tax returns) or where a sub-fund has been transferred but the remainder of the sub-funds (divisions) of the superannuation fund remain.
- ***Will the previous roll-over relief continue to apply?*** Roll-over relief was previously provided to assets merged to comply with licensing requirements under the superannuation safety reforms.
- ***Will there be any requirement by the receiving fund to segregate any losses received or rolled-over for the benefit of transferred members (rather than the all members of the combined fund)?***

Should you have any questions regarding the submission, please contact myself or Daniel Caruso on 02 9299 3022.

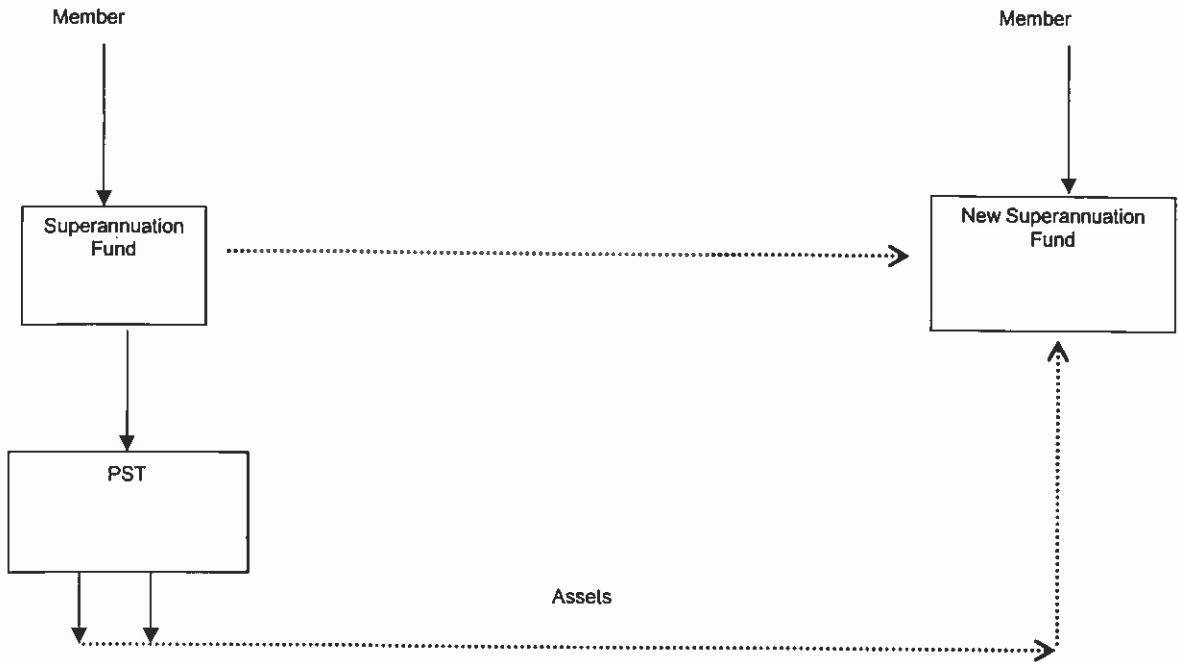
Yours sincerely



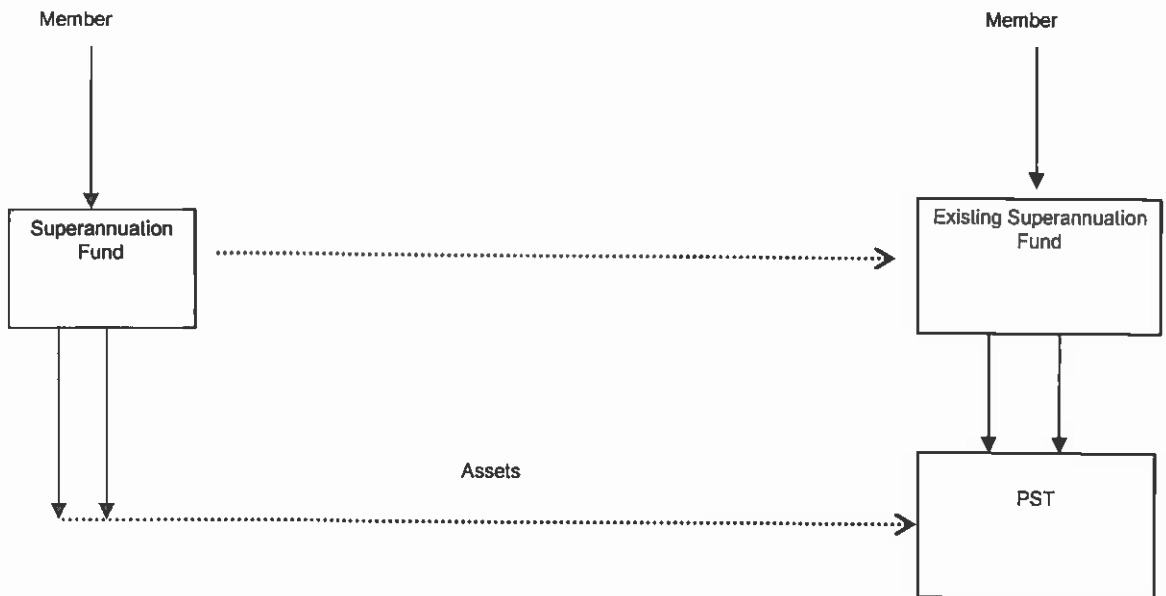
Richard Gilbert
Chief Executive Officer

ATTACHMENT A – EXAMPLES OF VARIOUS POTENTIAL MERGERS

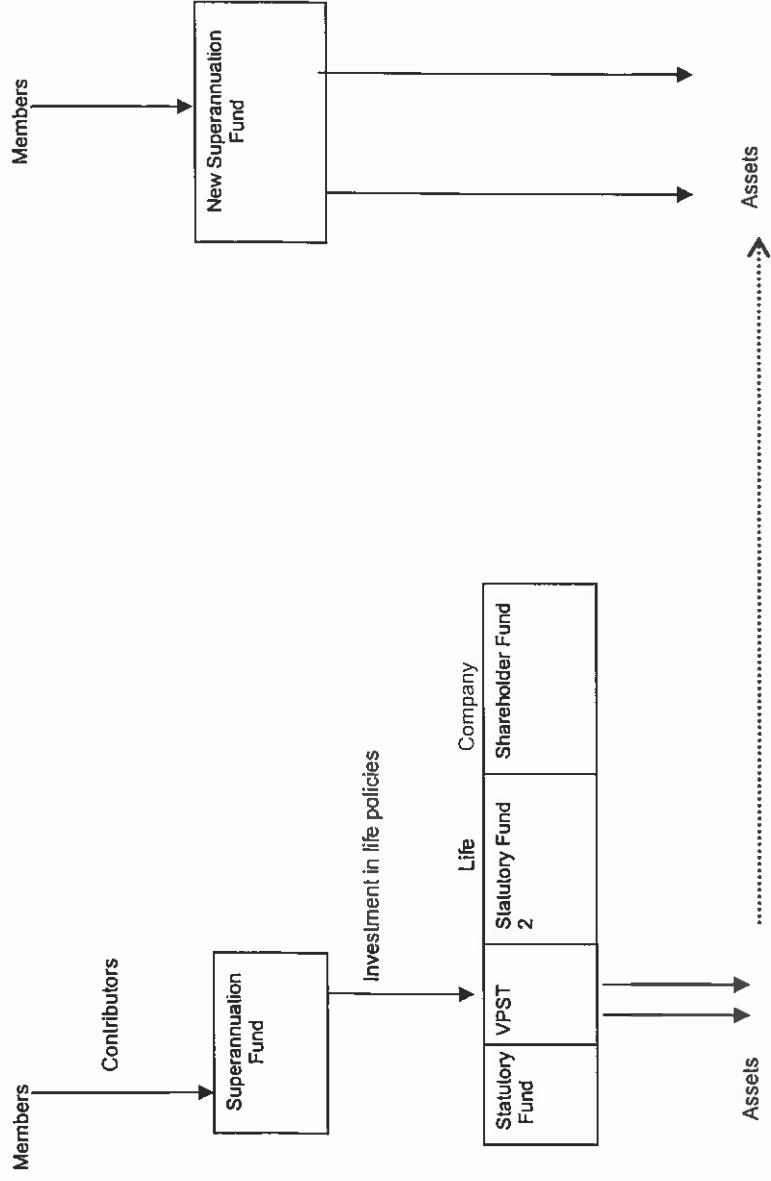
EXAMPLE A1 – Merger of a Pooled Superannuation Trust with a new Superannuation Fund



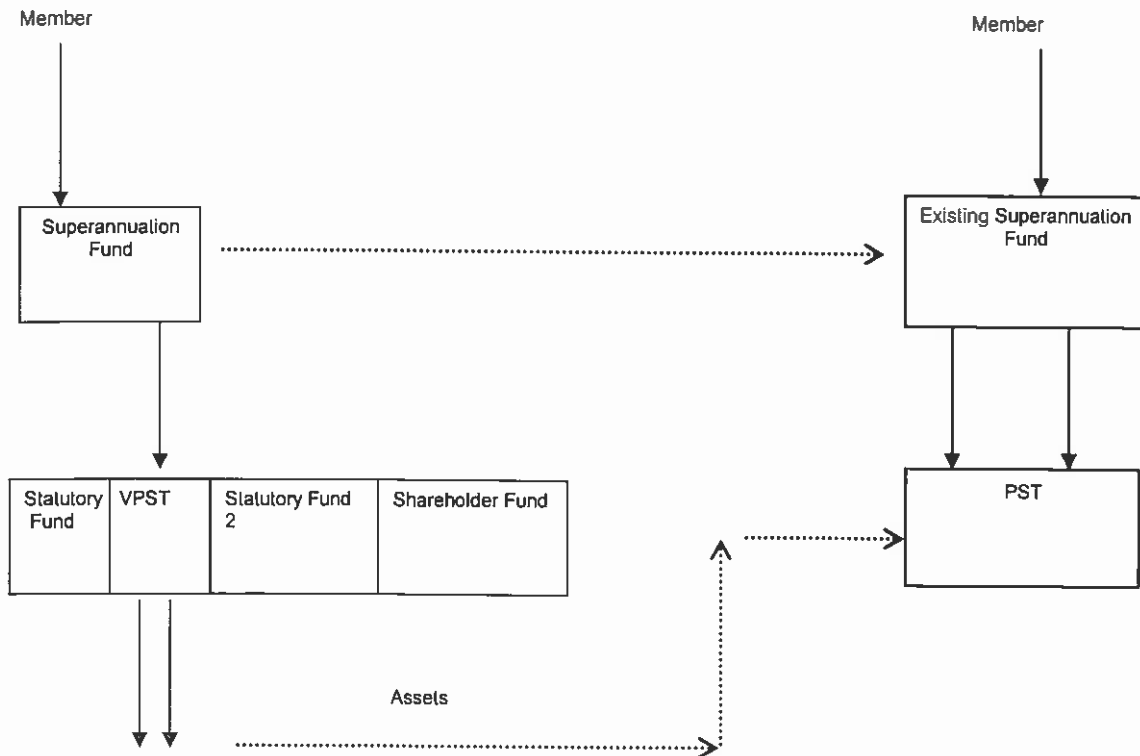
EXAMPLE A2 - Merger between a Superannuation Fund and a Pooled Superannuation Trust



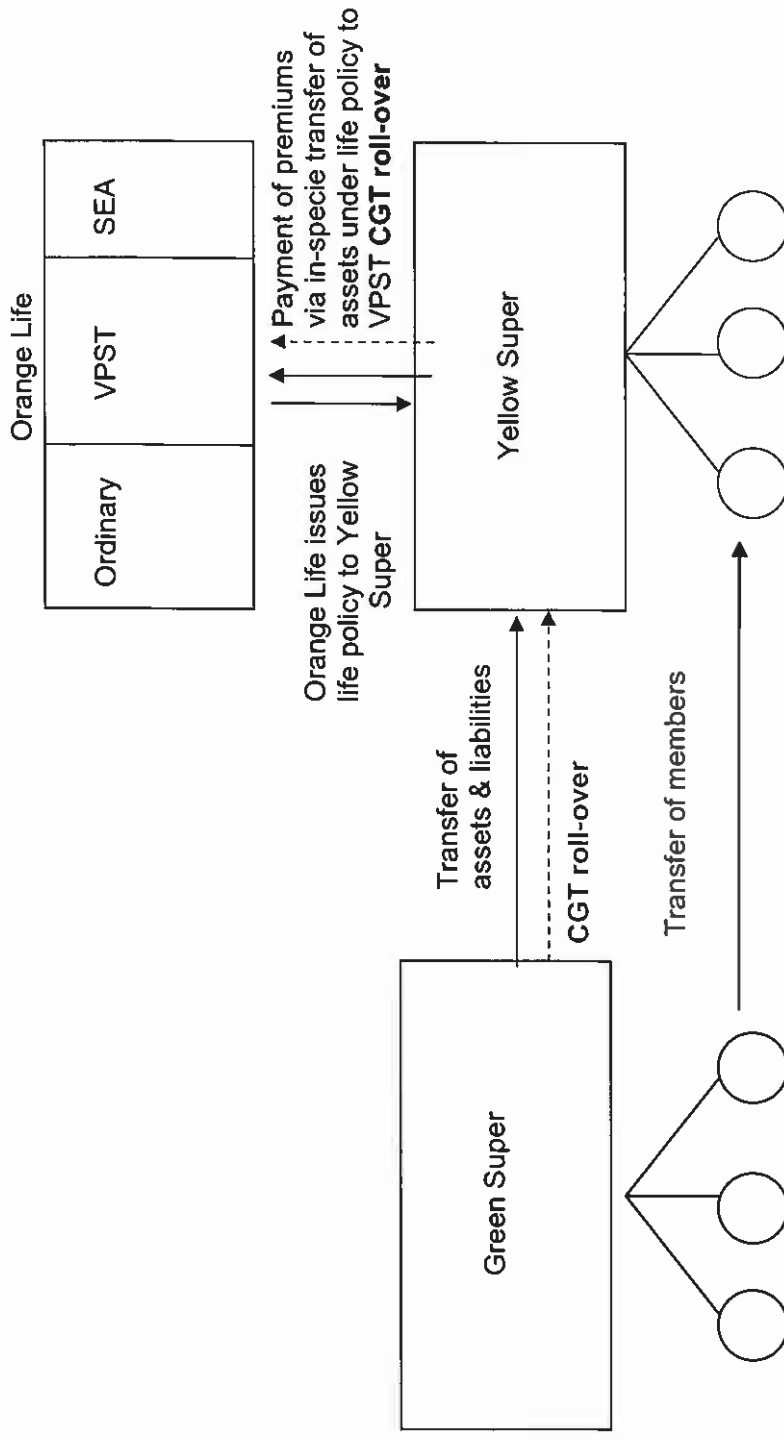
EXAMPLE A3 - Merger of a life insurance company superannuation fund into a successor fund



EXAMPLE A4 – Merger of a Virtual Pooled Superannuation Trust into a Pooled Superannuation Trust



EXAMPLE A5 – Merger of a Superannuation Fund with assets paid indirectly into a Virtual Pooled Superannuation Trust



EXAMPLE A5 - Description

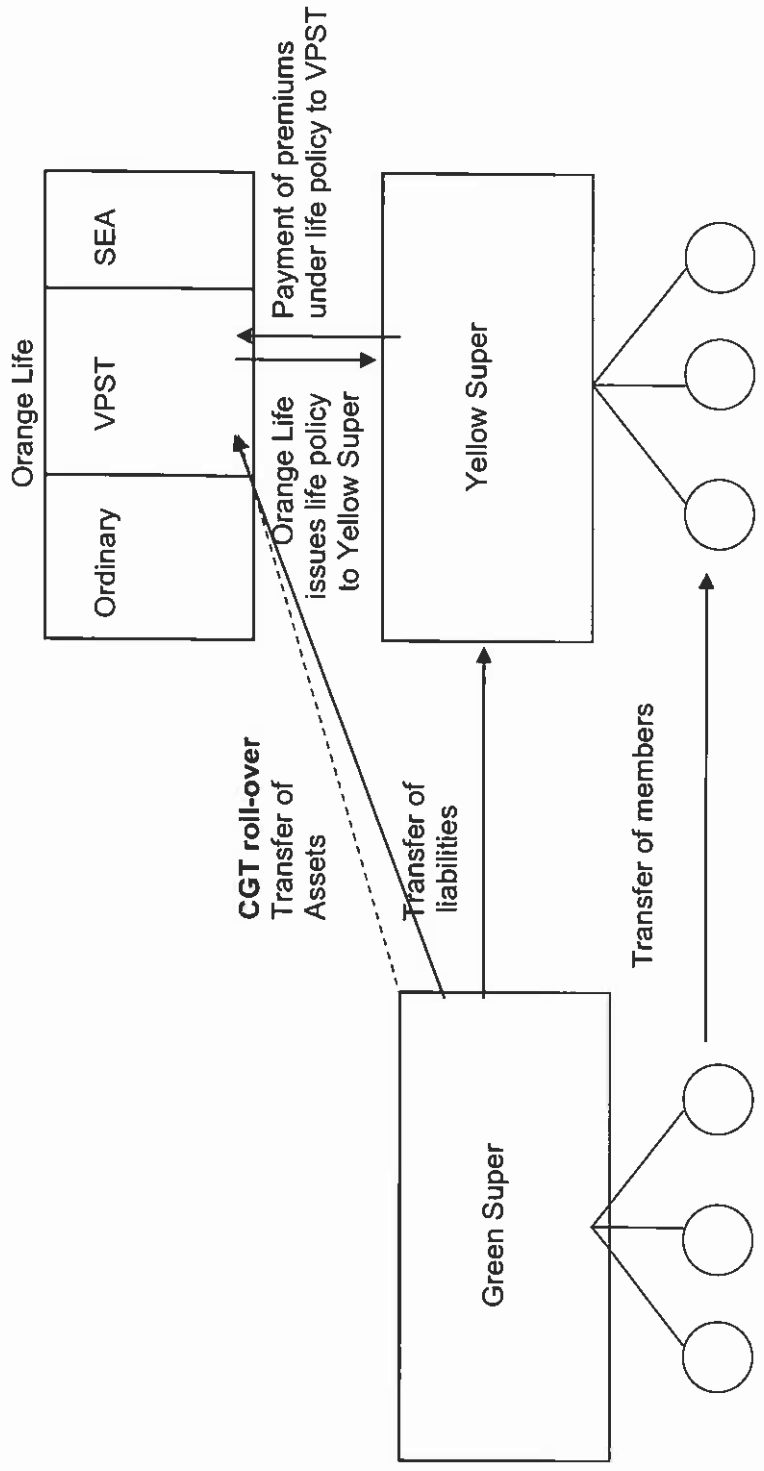
Green Super is a complying superannuation fund with 10,000 members. It holds various assets, some of which have unrealised capital gains while others have unrealised capital losses. The trustee of Green Super considers merging with Yellow Super. Yellow Super is a complying superannuation fund with 100,000 members. Yellow Super invests via a life policy into the Virtual Pooled Superannuation Trust (VPST) within Orange Life. This merger would be achieved by Green Super transferring its assets, liabilities and 10,000 members to Yellow Super before being wound up.

Among its assets, Green Super owns 100,000 shares in Bear Ltd. These shares were acquired on 21 February 2007. The reduced cost base for each of these shares is \$10 (total reduced cost base of \$1,000,000) and at the time of the transfer they are worth \$5 each. The transfer of these shares would ordinarily realise a capital loss of \$500,000 for Green Super.

Green Super subsequently transfers its assets, liabilities and members' accounts to Yellow Super and is wound up. When Yellow Super acquires Green Super's assets, the first element of the cost base (or reduced cost base) of the 100,000 shares in Bear Ltd is \$10. This is equal to the cost base (or reduced cost base) of these shares in the hands of Green Super just before the transfer.

Yellow Super pays premiums to the VPST within Orange Life under the life policy as an in-specie transfer of assets. When Orange Life receives Yellow Super's assets, the first element of the cost base (or reduced cost base) of the 100,000 shares in Bear Ltd is \$10. This is equal to the cost base (or reduced cost base) of these shares in the hands of Yellow Super just before the transfer.

EXAMPLE A6 – Merger of a Superannuation Fund with assets paid directly into a Virtual Pooled Superannuation Trust



Example A6 - Description

Green Super is a complying superannuation fund with 10,000 members. It holds various assets, some of which have unrealised capital gains while others have unrealised capital losses. The trustee of Green Super considers merging with Yellow Super. Yellow Super is a complying superannuation fund with 100,000 members. Yellow Super invests via a life policy into the Virtual Pooled Superannuation Trust (VPST) within Orange Life. This merger would be achieved by Green Super transferring its liabilities and 10,000 members to Yellow Super, and its assets to the VPST within Orange Life, on the direction of the trustee of Yellow Super, before being wound up.

Among its assets, Green Super owns 100,000 shares in Bear Ltd. These shares were acquired on 21 February 2007. The reduced cost base for each of these shares is \$10 (total reduced cost base of \$1,000,000) and at the time of the transfer they are worth \$5 each. The transfer of these shares would ordinarily realise a capital loss of \$500,000 for the VPST within Orange Life.

Green Super subsequently transfers its liabilities and members' accounts to Yellow Super, and transfers its assets to the VPST within Orange Life, on the direction of the trustee of Yellow Super. When Orange Life acquires Green Super's assets, the first element of the cost base (or reduced cost base) of the 100,000 shares in Bear Ltd is \$10. This is equal to the cost base (or reduced cost base) of these shares in the hands of Green Super just before the transfer.