24 August 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: Exposure Draft – Tax Laws Amendment (2012 Measures No. 5) Bill 2012: Merging superannuation funds

BT Financial Group (BTFG) welcomes the opportunity to comment on the Tax Laws Amendment (2012 Measures No. 5) Bill 2012: Merging superannuation funds (the Exposure Draft).

We strongly support the policy intention of ensuring that individual members are not financially disadvantaged by the Capital Gains Tax (CGT) consequences of superannuation fund mergers.

Our submission focuses on three key issues that we believe should be addressed within the Exposure Draft. Our recommendations would ensure that the proposed changes work as intended and individual members are not financially disadvantaged by other taxation considerations resulting from superannuation fund mergers.

1. Transferred tax losses to be deductible in the transfer year

The proposed amendments to subsections 310-410(1)(b)(i) and (ii) (item 7 of the Exposure Draft legislation) are intended to "refresh" the transferred tax losses so that the tax losses will be taken to be losses made by the successor funds and can be utilised by the successor funds either in the transfer year or future years. The policy objective is clearly stated in paragraph 4.1.4 of the Proposals Paper and in paragraphs 1.30 to 1.31 of the Explanatory Memorandum. BTFG strongly supports this policy objective as it is critical to facilitate industry consolidation and transition to Stronger Super.

To achieve the above policy objective, section 310-40 will have to be amended in order to avoid any inadvertent denial of the transferred tax losses due to the operation of section 36-15. If section 310-410 is amended in accordance with item 7 of the Exposure Draft, the transferred tax losses will be inadvertently denied as follows:

a) subsection 36-15(1) will operate so that the transferred tax losses will not be deducted in the transfer year and will be carried forward to the following year; and

b) subsection 36-15(3) will operate in the following year so that the transferred tax losses will be deducted from the successor fund's net exempt income.

There were a lot of superannuation fund mergers happened under the Government's former CGT merger relief. As a result, it is almost certain that the super funds that can potentially be successor funds for mergers have significant number of pension members and significant exempt income. A merger of a loss super fund and another fund will very likely wipe out all of the tax losses by net exempt income, reducing members' retirement benefits.

Members of loss funds will be significantly disadvantaged if the transferred tax losses will be simply wasted on exempt income. This detrimental tax outcome is a crucial obstacle for loss super funds to merge with other super funds in the best interest of members. If section 310-410 is not properly amended, trustees of loss super funds will be forced to abandon indefinitely any merger plans notwithstanding that mergers are otherwise in the long-term best interest of members.

Recommendation:

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

BTFG supports the following changes to section 310-40 as recommended by the FSC:

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."

2. 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:

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:

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

3. Members may permanently lose any “tax-free component” of their account upon transfer.

If the transfer of a member balance to another super fund 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 another superannuation fund. 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.

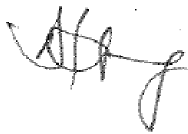
Recommendation:

We recommend the transfer of a member balance to another super fund, 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 new 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. Please feel free to contact Lucas McKay on (02) 8253 2725 to arrange a suitable time.

Yours faithfully



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