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Senate Economics Committee
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Attn: [redacted]

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Dear Committee members

Asset rollover for merging superannuation funds - Schedule 2 Tax Laws Amendment (2009 Measures No 6) Bill 2009

Thankyou for allowing us an opportunity to raise an issue of concern in relation to the asset rollover for merging superannuation funds proposed to be provided by Tax Laws Amendment (2009 Measures No 6) Bill 2009 ("**Bill No 6**").

We have a number of clients who are interested in the operation of the asset rollover and for whom the matter we raise in this letter is relevant.

1 The issue - is a real transfer necessary?

1.1 Our concern relates to the scope of "arrangements" by which the relevant assets may be "transferred" between the funds, life companies and PSTs, which may be covered by the asset rollover in Subdivision 310-D.

1.2 In particular, we are concerned that an arrangement involving the redemption of interests in a managed fund by the "transferring entity" and the replacement of those interests with new interests in the managed fund issued to the "receiving entity" may not be covered.

1.3 In certain cases an arrangement for the "transfer" of interests in a managed fund might be sought to be structured by way of redemption and reissue rather than direct transfer. For example, in the case of many managed funds, the redemption and issue of interests occur regularly in the ordinary course, whereas a transfer would involve a bespoke transaction requiring processes and actions that fall outside those normally managed by the product administration system.

1.4 The common use of custodians by life companies, trustees of superannuation funds and responsible entities of managed investment schemes presents a further example. For a prospective "transfer" of assets between a life company and a superannuation fund, it is quite conceivable that both the life company and the trustee of the fund would have their respective assets held by the same custodian. In that instance, there is no need for a transfer

of assets as such. Rather, the "transfer" could be effected by an appropriate direction to the custodian.

1.5 To deny rollover relief in these circumstances would seem to be contrary to the spirit of the proposed amendments and the stated policy. In particular, from a tax policy perspective, there is no apparent reason for preferring one mechanism for effectuating the asset "transfer" (ie direct transfer) over another (ie redemption and reissue or direction to a custodian).

1.6 Our concern that such transactions might not be covered, arises primarily due to statements in the Explanatory Memorandum to Bill No 6, although we believe the matter could also be put beyond doubt in the Bill itself.

2 The stated policy

2.1 At various places in the Explanatory Memorandum statements are made which evidence the intention to remove impediments to merger proposals and a reluctance to dictate the manner in which a merger might be effected:

"In light of the uncertain conditions in the global economy and recent global financial market turmoil, it is important that potential barriers to a robust and efficient superannuation industry are minimised. This measure will enhance the efficiency and robustness of the superannuation system in response to these uncertainties." (para 2.8)

"The broad term 'arrangement' is used in these provisions as it is not intended to limit the manner in which superannuation entities may merge." (para 2.13)

"The provision does not specify the particular CGT events that may happen, but refers to CGT events generally. This ensures that the rules accommodate the wide range of transactions and CGT events that may occur" (para 2.60).

2.2 Consistent with the stated intention to allow flexibility in the structure of the merger transaction, while the provisions of Bill No 6 dealing with the asset rollover contemplate the assets leaving one fund and being replaced in another fund, they do not specifically require a formal transfer of those assets.

2.3 The conditions for the asset rollover in section 310-45 are:

Condition 1 - under the "arrangement", one or more CGT events occur in relation to assets so that they cease to be owned by the superannuation fund, life company or PST. The CGT events are defined in section 310-45 (2) as "transfer events" but that is by way of definition only; it does not dictate the form of the transaction.

Condition 2 -the CGT events occur in the same year;

Condition 3- as a result of each CGT event "an asset" becomes an asset of the continuing superannuation fund, life company or PST. The reference to "*an* asset" (rather than "*the* asset") implies that the asset which is the subject of the third condition does not need to be

the same asset as was held by the fund, life company or PST in Condition 1. The asset in Condition 3 is defined as the "received asset" and the continuing fund, life company or PST in that condition is referred to as the "receiving entity" but again, we suggest, this is simply a matter of definition rather than dictating that a transfer from one entity to another is required.

2.4 Further, in Part 2 of Schedule 2 of Bill No 6, in making consequential amendments, a number of CGT events are covered. In particular, CGT event C2 (which would cover a redemption) is specifically addressed as well as Events A1 and E2 (which would each cover transfer). If a real transfer was required, it seems to us there would be no need to amend the provisions dealing with capital proceeds in relation to Event C2 (see item 7 of part 2 of Schedule 2, amending section 116-25 and item 8 inserting new section 116-110).

3 A narrowing of the operation - the possible need for a real transfer

3.1 There may be some room for debate about the meaning of the requirement in condition 3 that an asset becomes an asset of the receiving entity " as a result" of the relevant CGT event by which an asset ceased to be owned by the original fund, life company or PST. We think that the way in which the remainder of the conditions are worded, and in particular, the fact that "an asset" must become an asset of the receiving entity, rather than "the particular asset" which ceased to be held by the original entity, arguably allows a broad construction of the nexus requirement in condition 3. That view would be based on arguing that the issue of units only occurs because of or "as a result of" the redemption of units.

3.2 This argument becomes more difficult in the face of various statements made in the Explanatory Memorandum.

3.3 First, the explanatory memorandum opens (at paragraph 2.3) by giving the example of CGT events A1 and E2 being involved in assets transfers. No reference is made to CGT event C2 and the redemption of interests. This may not be so important since the relevant paragraph does not purport to give an exhaustive list of relevant CGT events, however, it does set the scene for an analysis which, for the remainder of the Explanatory Memorandum, seems confined to actual transfers.

3.4 Paragraph 2.58 refers to the rollover relief being available for "*assets that are to be transferred from the transferring entity to another entity (the receiving entity) under the arrangement to merge superannuation funds provided certain additional conditions are satisfied.*"

3.5 Similarly, paragraph 2.63 states "*the arrangement to merge funds covers the transactions under which the assets and members are transferred between the merging funds*". This reference may not be fatal, since in subsequent paragraphs, the Explanatory Memorandum refers to the members of the relevant fund "exchanging" their interests in one fund for another. These are the same members who were referred to as being "transferred" in paragraph 2.63 which might suggest "transfer" in not being used in a technical sense.

3.6 The greater difficulty, we suggest, is found in the description of the Condition 3 in paragraph 2.67 where reference is made to "*the CGT assets*" becoming assets of another

fund, life company or PST. This seems to be a reference back to the original assets held by the first fund, life company or PST, and is borne out by example 2.6 which involves an ordinary transfer of assets.

4 Proposed Solution

The Bill

4.1 Arguably the Bill could remain in its current form and cover an effective transfer by way of redemption and reissue, since the conditions in section 310-45 refer to:

- "one or more CGT events" happening under an arrangement - not just event A1 or Event E2;
- the transferring entity must "cease to own" the assets, rather than "transfer" the assets;
- "an asset" must become an asset of a new fund, PST or life company "as a result of the CGT event" - the asset need not, it seems, be the asset originally held by the "transferring entity".

4.2 Ideally however, particularly having regard to the argument open in relation to the causative link on Condition 3 (see 3.1 above), the question could be put beyond doubt by specifically stating that the asset acquired by the "receiving entity" does not need to be the same as the asset which the "transferring entity" ceased to hold. Similar concepts were involved in connection with the rollover for merging superannuation funds to meet licensing requirements under Tax Laws Amendment (2005 measures No 2) Bill 2005 which introduced subdivision 126-F. In describing the conditions for rollover, section 126-210(1) requires that:

- a fund ceases to hold assets;
- because of the cessation CGT assets which are identical to those held by the first fund start to be held by a new fund (*"whether or not all the identical assets were the [first fund's] assets)"*.

4.3 The clarification of the operation of section 310-45 in circumstances broader than a conventional transfer could be as simple as the inclusion of the words "whether or not the received assets were the assets of the transferring entity immediately before the relevant transfer event" at the end of subsection 310-45(4), in the same manner as that form of words appears in section 126-210(1).

4.4 As a safeguard in order to ensure that the received assets replicate the original assets, the concept of " identical assets" from section 126-210 could be translated into section 310-45, in lieu of the concept of "received assets".

The Explanatory Memorandum

4.5 Amendments required to the Explanatory Memorandum to clarify the scope of the rollover would depend on the approach taken in the Bill.

4.6 At a minimum, we would suggest that a statement be inserted to reflect the fact that a legal or equitable transfer is not required but that the redemption (giving rise to Event C2) and reissue of interests are also included. This might also be represented by an additional example.

4.7 We would be happy to provide some suggested drafting to address the points above if this would be useful in your consideration of this submission. Please do not hesitate to contact us if this could be of assistance.

Yours faithfully