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Senator Hurley, Chair
Senate Economics Legislation Committee
Parliament House
ACT

economics.sen@aph.gov.au

Inquiry into the Tax Laws Amendment (2009 Measures No. 6) Bill 2009

Dear Senator

AXA is a leading provider of superannuation, financial planning and other financial products to retail clients. AXA welcomes the opportunity to provide a submission to the Committee's inquiry into the Tax Laws Amendment (2009 Measures No. 6) Bill 2009.

Our comments relate to schedule 2 of the Bill. AXA is supportive of the proposal to provide Capital Gains Tax Rollover relief to superannuation funds that are merging. We propose two different types of amendments to the Bill. The first proposal is that Capital Gains Tax Rollover Relief should be permanently available in all instances where superannuation entities are merging. AXA recognises that this would be a fundamental shift from the limited relief proposed by the Bill, but believe that it is justified.

AXA's other proposals are more limited, suggesting amendments to the Bill that will overcome some practical difficulties that will arise for trustees in seeking to utilise the proposed relief.

If you have any queries in relation to the attached submission paper or would like to discuss any of the comments raised, please contact Doug McMeekin, AXA Australia Tax Manager, on 03 8688 4226.

Yours sincerely

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Submission to the Senate Economics Legislation Committee Inquiry into the Tax Laws Amendment (2009 Measures No. 6) Bill 2009

Introduction

AXA is a leading provider of superannuation, life insurance, financial planning and other financial products to retail clients. AXA welcomes the opportunity to provide a submission to the Committee's inquiry into the Tax Laws Amendment (2009 Measures No. 6) Bill 2009.

Our comments relate to schedule 2 of the Bill. AXA is supportive of the proposal to provide Capital Gains Tax Rollover relief to superannuation funds that are merging. We propose two different types of amendments to the Bill. The first proposal is that Capital Gains Tax Rollover Relief should be permanently available in all instances where superannuation entities are merging. AXA recognises that this would be a fundamental shift from the limited relief proposed by the Bill, but believe that it is justified.

AXA's other proposals are more limited, suggesting amendments to the Bill that will overcome some practical difficulties that will arise for trustees seeking to utilise the relief in its proposed form.

The application of Capital Gains Tax to Superannuation Funds

In a superannuation fund the assets are owned by the trustee (the legal owner) on behalf of the superannuation fund (the beneficial owner), to provide benefits for the superannuation fund's members.

Capital Gains Tax is payable when a CGT event occurs. In the case of a superannuation fund, a CGT event normally occurs when there is a change in the legal and beneficial ownership of an asset. In the day to day operation of a superannuation fund, a CGT event occurs when a member requests payment of their superannuation benefit or exercises member investment choice to switch from one investment option to another. The trustee sells assets held within the superannuation fund to pay benefits or change investments. In this case both the legal ownership and beneficial ownership changes and any capital gain on the asset is subject to tax (at concessional rates).

The subject of the relief contained in schedule 2 of the current Bill is the merger of two or more superannuation funds. Typically this means that the trustee of each of the merging funds has decided that it is in the interests of the members of the funds involved that a merger occurs, usually to achieve economies of scale and other efficiencies. Normally this involves one of the funds (the transferring fund) being closed, with the members and the fund's assets transferring to the other fund (the destination fund).

Permanent CGT Rollover Relief for superannuation fund mergers

In the merger described above, the assets have not been sold, and are still being used to support members' interests in the (merged) superannuation fund. However, under the CGT rules there has been a change in legal and beneficial ownership as the fund within which the assets are held has changed. Assets that were previously held in fund A to support the benefits of the members of Fund A are now held in (merged) Fund B to support the benefits of the former members of Fund A.

AXA submits that a merger of two funds, where the assets are retained to support the benefits of members of the merged entity, should not be considered a CGT event. While the vehicle under which the assets are held has changed, the assets are still held to provide superannuation benefits for the same group of members. The ultimate beneficiaries have not changed.

The argument for charging CGT in the event of a merger of two superannuation funds is even more unsustainable when the implications of member investment choice are considered.

While legally all assets are held by the trustee for the benefit of all members of the fund, in many funds which allow member investment choice, the trustee sells and purchases specific parcels of assets in accordance with the individual member's instruction, and accounts for earnings, expenses and tax effects at the member account level. In this case, specific assets are held for a specific member, and in the case of a merger of two superannuation funds these assets continue to be held specifically for the benefit of that member. These assets will only be disposed of when the member makes a decision to change investments or leave the fund. The merger of two superannuation funds has little real impact in this situation; the same assets continue to be held for the same member.

Rather than amending the existing legislation to provide temporary conditional relief for such mergers, AXA submits that the legislation should be permanently amended to exclude the transfer of assets in the case of a merger of two or more superannuation funds from the definition of a CGT event.

Such an amendment would not, in AXA's submission, involve a loss of taxation revenue. AXA submits that the more accurate construction is that it will prevent mergers of superannuation funds from artificially and inappropriately bringing forward the collection of CGT where, except for the merger, this would not occur until assets were disposed of to fund payment of a benefit to a member or to implement changed investment instructions.

Practical difficulties with the proposed relief

In the event that the committee does not accept our submission above, AXA submits that some amendments are required to address some practical difficulties and risks for trustees seeking to rely on the relief provided by the Bill.

Mergers of superannuation funds are not organised overnight. They typically take months to plan and several weeks more to implement. The chief difficulty with the proposed relief in its current form is that it only applies where the funds are in a net capital loss position at the date of the merger.

With rising markets, there is a risk that a net capital loss position can very quickly become a net capital gain position. The reality is that this assessment of the fund's capital gain/loss position can only be made in retrospect. Depending on the size of the fund, and the nature and extent of the assets it may take several days or weeks to determine the actual capital loss/gain position of the fund at a particular date.

Under the proposed relief a trustee could readily discover that a merger that was expected to be protected from CGT by the rollover relief is in fact ineligible because of an increase in the value of the fund's underlying assets immediately before the merger.

The consequences of this for a trustee are significant, as such a merger can only occur on the basis that the transfer provides the members with equivalent rights and benefits. If the transfer leads to CGT being incurred, the funds assets are reduced to meet the liability, and the members' benefits are similarly reduced. If this occurs, the trustee could be required to compensate the members to restore their benefits to the pre-transfer value. Depending on the size of the fund and the capital gain, this could amount to millions of dollars.

AXA submits that the Bill should be amended to protect trustees from being subject to the risk of needing to compensate members for CGT incurred in such a situation. The most effective way to achieve this is to remove the eligibility requirement that the transferring fund be in a net capital loss position at the time of the merger. Allowing funds to merge without incurring CGT at that point in time does not result in a loss of CGT; CGT on the gains will still be incurred when the assets are disposed of at a later date by the trustee of the merged funds.

Alternatively, AXA proposes that the relief should apply to a merger where the net capital gain/loss position of the merged funds was a net capital loss on the day three months prior to the merger date. A difference of three months between the assessment date and the merger date will provide sufficient time for the aggregate capital gain/loss position to be determined before the merger proceeds, rather than being assessed as at the merger date but not being known until some time after the merger has occurred. It will allow the trustees to proceed with the merger with certainty in relation to the CGT liability.

This outcome could be achieved by amending paragraph 310-55 of the Bill so that instead of referring to the capital loss position 'just before the event' it refers to the capital loss position 'three months before the event'.

This proposed amendment will allow the Bill to achieve its intended effect of facilitating mergers. As currently drafted, the risk that a rising market will have tipped the fund into a net capital gain position on the merger date, with the adverse consequences outlined above, can discourage trustees from utilising the proposed relief.

AXA submits that adopting either of these proposals does not involve a loss of taxation revenue, but prevents mergers of superannuation funds from artificially and inappropriately bringing forward the collection of CGT where, except for the merger, this would not occur at this time.

Pooled Superannuation Trusts and the complying superannuation business of life insurance companies

The exposure draft of the Bill issued for comment in August 2009, provided CGT relief where the original entity was a complying superannuation fund, a pooled superannuation trust (PST) or the complying superannuation business of a life insurance company. The Bill before the Committee does not provide relief for PSTs or the complying superannuation business of life insurance companies.

AXA submits that extending the relief to PSTs and complying superannuation business of life insurance companies provides an opportunity for significant rationalisation in these two sectors. At least as strong a case exists for extending the relief to these products as for providing it to superannuation funds to remove the disincentives and barriers that currently exist for such rationalisations.

It is not clear whether the exclusion from the final Bill now before Committee is deliberate or is an unintended consequence of the significant drafting changes between the exposure draft and the Bill. In any case, AXA submits that the Bill should be amended to extend the relief to the following situations as outlined in the exposure draft:

- original entity is a PST: where the assets held by the PST are transferred to a complying superannuation fund or the complying superannuation business of a life insurance company
- original entity is a life insurance company: where the assets held by the life insurance company are transferred to a complying superannuation fund or PST

While once quite significant, PSTs and the complying superannuation business of life insurance companies are now relatively small and isolated elements of the overall superannuation system. Rationalisation of these

elements would help reduce the overall complexity of the superannuation system and enhance its efficiency.