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The Secretary
The Board of Taxation

By email: cgtrollovers@taxboard.gov.au

Dear Sir/Madam

Consultation on capital gains tax roll-over

The Consultation Guide states the terms of reference of the review as being the identification and evaluation of "opportunities to rationalise the existing CGT roll-overs and their associated provisions into a simplified set that have substantially similar practical effect, but are easier to use and interpret. In doing so, the Board should have regard to the main categories of roll-overs, namely, roll-overs where there is no change in underlying economic ownership and roll-overs where the disposal is involuntary".

This submission concerns the "no change in underlying ownership" principle in the context of a self-managed superannuation fund, ie small superannuation fund with not more than 4 members. This submission is based on a real life example which does not appear to have been contemplated when the current roll-over relief provisions in sections 126-D and Division 310 of the *Income Tax Assessment Act 1997* (**Div 310**) were considered.

As you will be aware, the original Div 310 temporary rollover relief that was provided from 24 October 2008 to encourage the merger of superannuation funds after the GFC, although it did not apply to transfers between SMSFs, it did apply to transfers from SMSFs to larger complying superfunds. Although the modified version of the Div 310 rollover relief that has applied since 1 October 2011 excluded SMFs, the Explanatory Memorandum (EM) does not provide an explanation for doing so.

In any event, it is submitted that in order for the tax impact on the benefits of all superannuation members, whether members of an SMSF or of an APRA regulated complying superfund, to be fair and equitable when there is a transfer of member assets between superfunds, the CGT rollover relief for assets and losses that is available under Div 310 to APRA regulated complying superannuation funds, should also be available for transfers between SMSFs.

In the EM, clauses 1.4 to 1.8 describes the potential impact, for members of APRA regulated superannuation funds, being a reduction in the value of their benefits, if the Div 310 CGT rollover relief options for assets and losses were not available for transfers of assets between APRA regulated funds.

The EM notes that if that CGT rollover relief was not available, trustees of APRA regulated superannuation funds, whose paramount duty is to act in the best interests of members of the fund, may determine not to transfer groups of members or all members to another APRA regulated superfund if in doing so the value of member benefits would be reduced, either by CGT tax payable earlier than would otherwise have been the case, or by the extinguishment of the value of tax losses still to be recouped.

This concern to not have the value of superfund member benefits reduced on transfer between APRA regulated superfunds should, it is submitted, apply equally to members of SMSFs who transfer their benefit, particularly their existing pension benefit, to another SMSF.

The example below brings out the urgent need for a change either in the law, or the practice of the Commissioner of Taxation.

Example (real life situation):

1. X Superannuation Fund (**Transferor Fund**) has two unrelated members being A and B.

2. A and B are the only trustees of the Transferor Fund.

3. A and B are both over 65 years old.

4. A is fully retired but B continues to work full time.

5. B continues to make concessional contributions to the Transferor Fund.

6. Both of the members' interests in the transferor Fund comprise of pension and accumulation amounts.

7. A's member interest in the Transferor Fund is much higher than that of B.

8. For both pension and accumulation interests – in amounts, and percentage to total members' interest - A's member interest is much more than that of B. The same applies to A's accumulation interest.

9. Both members have investments outside the Transferor Fund.

10. In relation to each of A and B's respective interests in the Transferor Fund, by agreement between the trustees and the members of the Transferor Fund, as part of their investment strategy, the members are allowed to choose how their members' interests are to be invested, for example, A might want real estate and publicly listed company shares because A has no real estate investment outside super, whereas B prefers mainly publicly listed company shares and a small number of unlisted shares as B has real estate investments outside super.

11. Each of them has their preferred banking or financial institution and preferred stock broker.

12. The records and accounts of the Transferor Fund are kept in a way where each investment or asset of the Transferor Fund is attributed or allocated directly to the respective members as demonstrated in the example below:

Name of company	Member	Number of shares	Cost base $	Market value $
ANZ	A	1,000	10,000	15,000
ANZ	B	500	7,000	7,500
BHP	A	2,000	38,000	40,000

13. The same system applies to other investments like cash, property etc, and to the income (including franking credit on dividends), of the Transferor Fund.

14. In preparing the accounts of the Transferor Fund, the accountant allocates any tax payable by the Transferor Fund between the two members according to the income derived from each of the members' respective investments in the Transferor fund. A similar exercise applies to any income tax refunded to the Transferor Fund. The tax on B's concessional contribution to the Transferor Fund is similarly allocated to B.

15. In other words, it could be said that the Transferor Fund has two sub-funds being one for each member so that each member's beneficial interest in the Transferor Fund is clearly and specifically identified. The members have realised that the two sub-funds system has become and is becoming more complex as the number of investments increases and

the rules governing superannuation funds are also increasingly becoming more complex.

16. To avoid the complexity, the trustees as trustees and also as members of the Transferor Fund have agreed to go their separate ways.

17. Member B establishes a new self-managed superannuation fund (**Transferee Fund**) with a corporate trustee, and the trustees of the Transferor Fund transfer the assets supporting B's pension interest in the Transferor Fund to the Transferee Fund.

18. B is the sole member of the Transferee Fund.

19. The transfer complies with all the governing rules of both the Transferee and Transferor Funds.

There are many other reasons why members may want to transfer from one SMSF to another SMSF. For example, due to changes in the family dynamics, or structure, of siblings who are members of an SMSF, they may want to have their own individual SMSF. Children may want to have their superannuation benefits in a fund separate from that of their parents. Similarly, family disputes, or disputes between unrelated members of an SMSF, may cause the members to transfer their benefits out to their own SMSFs.

In relation to the example described above, one SMSF specialist has written an article directly on this point: see attached copy of an article from Mr Bryce Figot (**Mr Figot**), and an article authored by Miranda Brownlee referring to the views of Mr Figot which, as can be drawn from that article, was expressed by Mr Figot at a webinar. The requirement to take many steps, as Mr Figot has outlined, clearly demonstrates the urgent need for change for clarity and certainty of position. With all due respect, the various steps and the complexity associated with taking those steps are inefficient, unproductive, irrational and unnecessary. The various steps could be more appropriately described as "red tape" and do not meet the two principles enunciated in the Board of Taxation Consultation Guide for Review of CGT Roll-Overs.

In the circumstances outlined in the example, whether the transfer of assets supporting B's pension is made in cash or in specie, under the ATO's practice, B's pension account in the Transferor Fund **must** be commuted before the transfer.

Under the current practice of the Commissioner of Taxation **(Commissioner**), if the trustee of the Transferor Fund transfers the assets supporting B's pension, in specie, either before or after commutation, the transfer may attract capital gains tax liability. According to the Commissioner, in order to avoid capital gains tax liability on a transfer of the assets, and only for that purpose, the trustee of the Transferor Fund must first convert the non-cash assets supporting B's pension into cash (ie dispose of them for cash and incurring associated disposal costs) before the commutation, then transfer the cash to the Transferee Fund. In realising the assets held in the Transferor Fund so as to convert them into cash, any capital gains or losses are crystalised, although no tax is payable upon crystallisation due to the member being in pension phase. Hence converting assets to cash before commutation avoids liability for CGT.

Further, the trustee of the Transferee Fund, at its discretion, can then invest the cash in assets (eg public company shares) (**new assets**) that are eligible for investment by SMSFs. Those new assets could be shares in the same companies in which the trustee of the Transferor Fund previously held shares which had to be converted into cash.

In other words, in order to avoid capital gains tax liability and only for that purpose, the non-cash assets supporting the pension at this point must first be converted into cash before commutation. Otherwise, the conversion into cash may result in capital gains tax liability if done after commutation. As the sole purpose of converting non-cash assets into cash is to obtain a tax benefit (no CGT liability) and for no other reason, query whether the Commissioner could set aside the tax benefit under the anti-avoidance provisions in Part IVA of the *Income Tax Assessment Act 1936*, and it would seem that he should as he has or no little discretion under those provisions.

The Commissioner's published view in relation to the example outlined above is as follows:

> *"Will CGT apply?*
>
> *SMSFs' member/trustee circumstances change and occasionally the end result is that a fund needs to be wound up or a member's benefit transferred to another complying superannuation fund.*
>
> *In these situations the question often asked is whether the assets supporting the pension can be transferred to a new fund and, if so, is there any capital gains tax (CGT) to pay on the transfer if the member has been receiving a pension?*
> *Fund-to-fund asset transfers are possible, however, CGT may be payable.*
>
> *There are a few issues that should be highlighted with trustees/members prior to any transfer:*

> • *pensions must be commuted before they can be rolled over,*
> • *commuting a pension creates an accumulation interest, and*
> • *CGT applies on the sale/transfer of assets from an accumulation interest.*
>
> *The only way to ensure CGT will not apply is to sell segregated pension assets prior to commuting a pension. The resulting cash can then be rolled over to a new fund and assets purchased at the new trustees' discretion."*

As expressed by Mr Figot in his article, there is no clear answer to the question of whether a pension must be commuted before the transfer. However, he says that "…one can read in between the lines." With all due respect, why should it be the case that one has to read between the lines to get an answer to such an important and significant question? Reading between the lines does not provide or promote clarity or certainty of position. The law should be made clear given the significant amount of funds invested through SMSFs.

In relation to commutation, paragraph 23 of the Commissioner's ruling TR2013/5: Income tax: when income stream commences and ceases clearly states that a "superannuation income stream ceases when a request from a member … to fully commute their entitlements to future superannuation income stream benefits for and entitlement to a lump sum takes effect." Paragraph 107 of the ruling cites a passage from Member Allen in Cooper and Commissioner of Taxation [2003] AATA 296, 2003 ATC 2123, the most relevant part of which states, "… In my opinion a commutation of a superannuation pension requires a beneficiary to make a conscious decision to exchange future entitlements, or a mixture of past and future entitlements, for some other forms of benefit (usually a lump sum) as permitted by the scheme." The need to make a conscious decision to commute an entitlement to a lump sum is reiterated in paragraph 41 of the Commissioner's Law Companion Ruling LCR 2016/9.

Referring back to the example above, if due to ignorance, inadvertence or any other reason unrelated to tax, B does not commute the pension before the transfer, and does not convert the non-cash assets into cash, what are the consequences of the transfer of the non-cash assets to the Transferee Fund? The situation becomes even more complexed.

CONCLUSION AND RECOMMENDATION

I endorse Mr Figot's view (as mentioned in Ms Brownlee's article) to the effect that what works for APRA regulated funds should also work for SMSFs.

Further, there should neither be a requirement to commute before the transfer, nor the requirement to convert non-cash assets into cash before commutation for the sole purpose of avoiding capital gains tax. The transfer of assets supporting a member’s pension between two complying SMSFs of which that same member has the whole beneficial ownership interest in the transferred assets both before and after the transfer should be treated as a roll-over without CGT consequences in the same way as is available to APRA regulated superfunds under Div 310. This will achieve the aims of the CGT roll-over provisions while at the same time achieving fairness and equity for all superfund members, whether members of an SMSF or an APRA regulated fund, as well as achieving simplicity, efficiency, reduced red tape and save unnecessary costs compared with the current process required by the ATO.

As I will be participating in the consultation meeting dealing with CGT roll-overs to be held by electronic means on 26 May 2020, I would be happy to elaborate further on this submission at that or later time.

Yours faithfully,

Millie Telan