12 February 2021

Ms Rosheen Garnon
Chair, Board of Taxation
The Treasury
Langton Crescent
PARKES ACT 2600

By email: cgtrollovers@taxboard.gov.au

Dear Ms Garnon

Capital Gains Tax (CGT) rollover relief consultation paper

The Financial Services Council (**FSC**) welcomes the opportunity to comment on the Board of Taxation's consultation paper on CGT rollover relief.

About the FSC

The FSC is a leading peak body which sets mandatory Standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advice licensees and licensed trustee companies. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing $3 trillion on behalf of more than 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange, and is the fourth largest pool of managed funds in the world.

FSC submission

The FSC supports the extension of general rollover relief to Attribution Managed Investment Trusts (**AMITs**) for the reasons outlined in the Board's consultation paper (page 46). The FSC considers this rollover relief should also be available to Managed Investment Trusts (**MITs**) – that is, those MITs that have not elected to enter the attribution regime. If rollover relief is available to AMITs, there is no clear reason why a general rollover relief should be available to MITs as well, because the attribution regime is quite distinct from issues relating to CGT liability.

Historically the bias against providing to roll-over relief to trusts has been driven by the concern to prevent discretionary trusts from accessing roll-overs. As a result of the concerns, unit trusts including widely held collective investment vehicles have typically suffered discrimination in access to CGT roll-over relief because of an unfounded suspicion that they may somehow be capable of being used for tax avoidance. Widely held collective investment vehicles have always been subject to commercial pressures and Corporations Act regulation that has restricted them from undertaking artificial activities. These vehicles have an excellent track record of tax compliance.

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The AMIT regime was the result of a comprehensive development process that resulted in an appropriate balance of interests between the Government, the investors and the industry. This cannot be said for any other vehicle. At the very least AMITs should be entitled to the same roll-over relief that any other vehicle is entitled but the argument extends to all widely held unit trusts.

Specifically it is worth noting that:

- The AMIT regime did not exist when CGT rollovers were enacted so a failure to mention them in current drafting of CGT roll-overs is a legacy of history as opposed to explicit tax policy.
- The establishment of a dedicated tax regime for managed investment trusts enables roll-over relief to be extended to many widely held collective investment vehicles while respecting historical policy concerns regarding discretionary trusts obtaining roll-over relief.
- Tax integrity concerns associated with making roll-overs available to managed investment trusts and AMITs are largely addressed by MIT and AMIT eligibility criteria and specific design features of the managed investment trust regime. In this regard:
- Eligibility to be a managed investment trust requires all trusts to satisfy specific rules, including unitholders (eg widely held and closely held tests), no trading activities and so on.
- A MIT or AMIT must be a trust where the rights of all members to income and capital arising from the membership interests in the trust are 'clearly defined' (ie fixed as opposed to discretionary). This in turn ensures that attribution of taxable income and consequences of roll-over relief appropriately align with the underlying economic ownership in the trust.
- The AMIT regime ensures cost base adjustments of membership interests reflect the upward and downward movement in value of the unit over the income year because of attribution and distribution reflecting the value shifted out of the trust, and therefore, out of the unit. Theses cost base adjustment provisions under the AMIT regime specifically provide for an alignment of economic and taxation outcomes for unitholders

These unit trusts being used as collective investment vehicles are significant players in the Australian economy holding $416 billion of people's savings in retail unit trusts as at September 2020.[1] These unit trusts are widely used by superannuation funds ($785 billion were invested into unit trusts by superannuation funds as at March 2020)[2] so this matter touches just about all working Australians.

An illustration of the need for CGT rollover relief is the value of assets trapped in out of date (or legacy) investment products. As indicated in the FSC's previous submission to this inquiry (page 4), in superannuation alone there was $162 billion in legacy superannuation products in 2017, which is 10% of the total assets in APRA-regulated (ie large) superannuation funds, with an estimated 2 million individuals trapped in these products.

In addition to this figure, there would be substantial value of assets trapped in out of date products in managed funds.

Trapping these millions of Australians' investments in lower yield, inefficient legacy products due to

[1] See https://www.abs.gov.au/statistics/economy/finance/managed-funds-australia/latest-release
Note this figure is retail unit trusts only and does not include wholesale unit trusts.

[2] Large super funds held $673.0 billion in unit trusts as at March 2020, see https://www.apra.gov.au/quarterly-superannuation-statistics while SMSFs held $111.7 billion in unit trusts as at the same date, see: https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Super-statistics/SMSF/Self-managed-super-fund-quarterly-statistical-report---March-2020/?anchor=Assetallocation#Assetallocation

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prohibitive CGT costs to exit from also means the Government collects less tax on earnings year-on-year due to that lower yield. The lower retiring account balances for these millions of Australians as a result of these lower yields in turn also results in higher means-tested Age Pension liabilities for the Government.

Therefore, providing the CGT relief is likely to have a long term benefit for those millions of Australians, the Government, and the responsible entities and responsible superannuation entities that would like to do the best for their customers by closing and exiting investors from administratively costly legacy products that they cannot attract new business into.

Provision of CGT relief to allow exit from legacy products should proceed without delay. To this end, the FSC has made a separate recommendation in this respect in its Pre-Budget submission to Government. For much the same reasons why we consider the CGT relief to be a pressing need, legislative changes should also be made to enable continued grandfathering of social security means-testing concessions for retired individuals after moving from legacy products and into current on-sale products.

People's savings are currently denied the economic efficiency that CGT roll-over relief can bring. The lack of rollover relief means savings are inappropriately trapped in out of date products. As detailed in the FSC's previous submission to this review, a lack of a rationalisation scheme means a financial system with:

- Higher fees
- Lower net returns, hence lower tax revenue
- Poorer customer disclosure and reporting
- Increased likelihood of errors
- Reduced likelihood of the products being suitable for the consumer
- Poorer use of technology
- Increased product proliferation
- Increased financial system risks
- Reduced competition
- Inhibited innovation
- Reduced scale economies and productivity
- Reduced savings and wealth, resulting in higher Government spending on income support.

We note the Board has outlined guiding policy principles for rollover (pages 15–16) and these principles support the case for CGT relief for product rationalisation.

We submit that it should be accepted that a product that a responsible entity or responsible superannuation entity has made a decision to close to new investors or new members is a legacy product.

The relief should not just be CGT relief for transfers of assets between unit trusts, but also transfers of assets to an investor, especially where the investor is a regulated superannuation entity such as a complying superannuation fund or pooled superannuation trust.

Concurrent transfer of capital and revenue losses that may become trapped or forfeited without relief should also be provided.

We submit that these changes can all be simply and quickly enacted through amending Division 310. The precedent for similar legislative change already exists in the previous amendments to Division 311 to enable implementation of MySuper investment structures without CGT cost.

Initiation of the relief should not just be limited to responsible entities of the unit trusts proactively closing their products and moving investors out of those products, but also:

- investment aggregators, especially including regulated superannuation entities, wishing to streamline their range of investments by exiting from legacy products they consider to be obsolete, inefficient or unsuitable for their current needs, including where they wish to hold those investment directly;
- individual dealer groups and employer groups who consider their existing selected or default fund has have become sub-optimal and, in the best interests of their member's/employee's wish to move their investments to another investment fund, or to another superannuation fund via successor fund transfer.

Concerns with irrevocable election

The FSC notes the concern in the Consultation Paper that general rollover for AMITs could 'subvert' the requirement for an irrevocable election to enter the AMIT regime (page 46). However, it is not clear that there is any significant tax mischief that would be enabled by providing general AMIT rollover. There are significant benefits to the AMIT regime, and these benefits would be lost on exit. Allowing AMITs to access general rollover would remove one of the few remaining issues that might stop entry into the regime.[3]

The Board's paper says that AMITs are unable to access existing business restructure rollovers. This is true for subdivision 124-N roll-over (disposal of assets by a trust to a company) for the E4 reason set out in the Board's paper. However, AMITs are able to access other roll-overs, particularly subdivision 124-M (scrip for scrip rollover) which might be more heavily utilised. To access scrip for scrip rollover, where unitholders exchange units in a trust for units in another trust, it is sufficient if the unitholders have "fixed entitlements" to the income and capital of the first trust. In the case of an AMIT, fixed entitlement is deemed by section 276-55.

In addition, MITs and AMITs that fail the existing eligibility tests will fail to be MITs or AMITs (respectively). So the regimes are not fully irrevocable.

This may alleviate the Board's concern that a general rollover regime might introduce an ability to exit the regime where none exists now. In fact, under the existing subdivision 124-M unitholders in an AMIT are already able to access roll-over where a scrip for scrip transaction is entered into with a recipient Division 6 trust (provided the Division 6 trust is a fixed trust).

In so far as regulated superannuation entities are investors into AMITs, those investors are already subject to effectively the same non-arms' length income rules and capital primacy rules as MITs and AMITs. If there is some perceived possible tax mischief from moving assets out of a managed investment trust or an AMIT, could it please be articulated so that we can address it in a submission directly.

The FSC is arguing that rollover relief should be available for both MITs and AMITs, which would further alleviate the concerns about 'subverting' the AMIT irrevocable election.

CGT discount for managed funds

We also note the following comment in the Board's consultation paper:

> [W]hilst a unit trust is generally a flow-through vehicle, unitholders in receipt of discounted capital

[3] The Government also has a policy proposing to tighten up the penalty regime for AMITs, a policy that the FSC considers is completely unnecessary and detrimental to the takeup of the AMIT regime. If the Government abandons this proposal, this will further reduce the likelihood that exiting the AMIT regime would be seriously considered. See page 25 of FSC's Pre-Budget submission for 2020–21.

gains can only retain the discount if they are ordinarily eligible to access the discount. In practice, if a unit trust distributes discounted capital gains to its unit holders, the unit holders are required to first "gross up" the capital gain and offset it by any capital loss the relevant unit holder has before the remaining capital gain is subject to the 50% CGT discount (if eligible)." (p48)

We note this finding by the Board argues against the Government's stated policy of removing the CGT discount for unit trusts. This policy — which the FSC does not support — was announced in the 2018–19 Budget but remains unenacted. The Government announced this policy because it considered there were investors in unit trusts that were using these trusts to gain inappropriate access to the CGT discount, but the quote from the Board above indicates this change is unnecessary.

Conclusion

The FSC would welcome the opportunity to discuss this submission. Please contact me in the first instance on [redacted]

Yours sincerely,

[redacted]

Michael Potter
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