Australian Government
Australian Taxation Office

Practical Compliance Guideline

PCG 2018/2

Propagation arrangements adopted by registrable superannuation entities

---

Relying on this Guideline

This Practical Compliance Guideline sets out a practical administration approach to assist taxpayers in complying with relevant tax laws. Provided you follow this Guideline in good faith, the Commissioner will administer the law in accordance with this approach.

Table of Contents **Paragraph**

What this Guideline is about

1. This Guideline sets out the ATO's compliance approach to the use of propagation in selecting assets for disposal.

Date of effect

2. This Guideline will apply from 1 July 2018.

Who does this Guideline apply to

3. This Guideline applies to registrable superannuation entities (RSEs) that contract with custodians to provide custodial and investment administration services for the RSE's assets.

4. An RSE is a regulated superannuation fund, an approved deposit fund or a pooled superannuation trust, but does not include a self-managed superannuation fund.

Background

5. The Commissioner's views on asset identification principles and record keeping methodologies are contained in CGT Determination TD 33 *Capital Gains: How do you identify individual shares within a holding of identical shares?*, Taxation Ruling TR 96/4 *Income tax: valuing shares acquired as revenue assets* and Taxation Ruling TR 96/7 *Income tax: record keeping – section 262A – general principles*.

6. TD 33 confirms that, for capital gains tax purposes, where a disposal occurs:

- shares are identifiable where they are individually distinguishable, for example, by reference to share numbers or distinctive rights or obligations attached to them
- it may not always be possible to identify the particular shares disposed of where they form part of a holding of identical shares
- for unidentifiable shares within an identical holding, the Commissioner accepts 'first-in first-out' as a reasonable basis of share identification.

7. TR 96/4 provides:

- where shares cannot be identified individually, appropriate accounting records of the acquisition and disposal of shares are considered sufficient to specifically identify shares to determine their value for taxation purposes
- in the absence of appropriate accounting records, the taxpayer cannot specifically identify these shares to a particular sale for taxation purposes.

8. TR 96/7 sets out the Commissioner's view on records sufficiently maintained to record and explain all transactions in accordance with section 262A of the *Income Tax Assessment Act 1936*.

What is propagation?

9. Propagation is a term adopted by custodians to describe a tax parcel selection process. Under propagation, the tax parcel selection methodology agreed with the RSE is applied across the RSE's asset class level holdings instead of being confined to the individual fund manager level.

10. When assets are disposed of, the relevant parcel is selected from the propagated portfolio for each transaction, based on the parcel selection methodology agreed with the RSE.

Our compliance approach

11. This section explains the Commissioner's compliance approach to propagation arrangements that satisfy the asset identification principles and record keeping methodologies described in TD 33, TR 96/4 and TR 96/7.

Where propagation is low risk

12. The Commissioner will generally not apply compliance resources to propagation arrangements when all of the following circumstances are satisfied:

(a) the custodian holds the legal title to the relevant assets of the RSE or on behalf of the RSE

(b) all assets subject to the propagation arrangement are held for the purposes of the relevant RSE

(c) the relevant assets are fungible, that is they are identical in all respects

(d) asset identification and selection are contemporaneous with the actual disposal transaction

(e) where the RSE uses either:

(i) a single pool of assets to support member interests, or

(ii) multiple pools of assets to support specific member interests and any propagated portfolios are confined within each specific pool

(f) where applicable, propagation only occurs within a sub-fund (as per section 69A of the *Superannuation Industry (Supervision) Act 1993* (SISA)) of the RSE, and

(g) assets identified for disposal under a propagation arrangement are also the assets identified to support reporting for non-tax regulatory or accounting purposes.

13. The Commissioner may devote limited compliance resources to confirm that particular propagation arrangements satisfy these parameters.

Where propagation is not low risk

14. The Commissioner considers that a propagation arrangement is not low risk where it does not satisfy each of subparagraphs 12(a) to 12(g) of this Guideline.

15. Furthermore, propagation arrangements the Commissioner considers are not low risk include those arrangements where:

(a) the RSE has segregated assets to support specific member interests in any way, including assets specifically identified under a member directed investment option, or assets segregated for members in retirement phase and propagation occurs across both segregated and unsegregated pools

(b) the RSE includes a sub-fund (as per section 69A of the SISA) that is treated as a separate RSE and propagation occurs across the assets of both RSEs, or

(c) propagation occurs across assets held by separate sub-custodians and each sub-custodian holds legal title to that portion of the portfolio.

16. Where a particular propagation arrangement is not low risk, the Commissioner may apply compliance resources to examine the arrangement in more detail.

The application of the general anti-avoidance provisions

17. The general anti-avoidance provisions may apply to a propagation arrangement adopted by an RSE, for example, where it is part of a scheme that exhibits the following type of features:

- the RSE is unsegregated for tax purposes, using the proportionate method for determining its exempt income under section 295-390 of the *Income Tax Assessment Act 1997* (ITAA 1997)
- it uses propagation to form a segregated current pension asset pool in accordance with section 295-385 of the ITAA 1997 containing an unbalanced allocation of assets with large unrealised gains
- these assets are realised, resulting in gains that are exempt from income tax, and

- once the assets are realised, the RSE ceases to maintain a segregated current pension asset pool which results in the unwinding of the arrangement and returning the RSE to its original unsegregated status for tax purposes.

18. In these circumstances, the Commissioner may conclude that the scheme was entered into, and carried out, to enable the RSE to make a choice to segregate and then unwind the segregation of its current pension asset pool, resulting in the obtaining of a tax benefit in the form of omitted assessable income.

Commissioner of Taxation
30 May 2018

References

ATOlaw topic(s)	Income tax ~~ Capital gains tax ~~ Other
Legislative references	ITAA 1936 ITAA 1936 262A ITAA 1997 ITAA 1997 295-385 ITAA 1997 295-390 SISA 1993 SISA 1993 69A
Related Rulings/Determinations	TD 33 TR 96/4 TR 96/7
ATO references	1-ASH6CTG
BSL	PGI