A Platform for Consultation

Financial Planning Association of Australia Limited

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Dr Alan Preston
Secretary
Review of Business Taxation
Department of Treasury
Parkes Place
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Dear Dr Preston

A Platform for Consultation

I am writing to you to convey the comments of the Financial Planning Association of Australia Ltd ("FPA") to the second discussion paper released by the Review of Business Taxation titled "A Platform for Consultation".

The main areas of concern for the FPA are as follows:

- Taxation of widely held trusts
- Discretionary inter vivos and testamentary trusts
- Amendments to capital gains tax ("CGT")
- Taxation of superannuation, including Pooled Superannuation Trusts ("PSTs")
- Taxation of life insurance

Our detailed comments on each of these areas are contained in the attached appendices 1-4 respectively.

Some more general comments concerning the overall discussion paper are set out below.

Deferred Company Tax

The proposal to reduce the corporate tax rate to 30% is to be strongly commended. The measure will contribute towards the desired effect of promoting Australia as an international financial centre. The proposals to introduce a deferred company tax regime will not, however, assist this objective. The deferred company tax option will result in an effective increase in the Australian tax burden of foreign shareholders. The overall tax liability of these shareholders will also be increased if no foreign tax credit is available in their home jurisdiction. We consider that the Australian authorities will have great difficulty in persuading foreign jurisdictions to amend double tax agreements to allow a greater foreign tax credit than is presently the case (given that it would effectively transfer revenue income from the foreign revenue authorities to the Australian authorities).

Foreign investors are likely to show a preference for low dividend, high capital growth stock, thereby placing pressure on high dividend paying Australian multinationals with substantial foreign shareholders. Deferred company tax will also trigger a charge to the profit and loss account of the relevant company. No doubt this will have significant impacts on the price of company shares and create distortions in relation to investor decision making.

The FPA considers the resident dividend withholding tax (“RDWT”) to be a preferable option, at least in terms of seeking to maintain Australia’s international competitiveness. The impact of the proposed tax regime, whether the deferred company tax option or the RDWT option applies, will also have significant effects on Australian shareholders. The refund mechanism for lowly taxed shareholders will result in a substantial acceleration of tax payments over the current system. This timing advantage generated for the revenue will be paid for by shareholders, who will include a substantial number of individuals on fixed incomes.

Widely Held Trusts

The proposal to retain the flow-through tax treatment of widely held public trusts is to be commended. However, the concept of widely held must be sufficiently defined in order to ensure that all trusts in the public trust industry retain this flow-through tax treatment including “wholesale” trusts, otherwise the policy intent of the flow-through proposal will be largely defeated. Further, clarification is required in relation to the tax treatment of Master Trusts and WRAP Accounts.

It is submitted that tax preferred income should retain its status when it flows through a widely held trust. The taxation of tax preferred income would create a marked difference between direct property investment and investment via a passive property trust. This would distort investment decisions and prejudice investors who have insufficient capital to invest directly in property.

Discretionary Inter Vivos and Testamentary Trusts

The FPA does not object to the broad notion of applying the entity tax regime to income distributed by discretionary trusts, whether established inter vivos or under the will of a testator.

However, the FPA is greatly concerned at the potential impact upon non-income amounts either distributed or made available from such trusts (for example, loans to family members, capital distributions upon winding up, etc).

The definitions of "dividend" and "distribution", the concept of "contributed capital", the application of the "profits first" rule, the extremely wide concept of "resettlement" and the interaction of the entity tax regime with the FBT rules must be re-considered, amended, etc for the purpose of ensuring that the legitimate use of discretionary inter vivos and testamentary trusts as family succession and asset protection vehicles is not penalised.

CGT

The FPA supports the move to cap the CGT rate for individuals at 30%. Continuing to apply the lower marginal rates where taxable income does not exceed the 30% threshold should promote simplicity in calculating an individual's tax liability. Reducing the corporate tax rate to 30% would also align that rate with the top rate applicable to capital gains derived by individuals.

The FPA believes that the degree of relief provided by averaging should depend upon the length of time that the relevant asset has been held by the individual. In other words, averaging should be determined by reference to the *term of the investment* with no arbitrary time limits (such as the current five-year rule). This measure should promote longer-term investment.

The proposal to provide rollover relief for scrip-for-scrip transactions is well overdue. Rollover relief should apply where the acquirer is a listed company, in relation to certain mergers between unlisted widely held trusts or between superannuation funds, and should also apply to scrip-for-scrip deconsolidations.

If the CGT tax rate is capped at 30% and averaging were to be calculated over the time of the investment as proposed above, then it may be possible to remove capital gains indexation concession without hardship occurring to lower-income taxpayers.

In relation to the CGT treatment of involuntary receipts, the FPA supports the option to defer CGT on such receipts. The FPA considers this option reflects the fact that the taxpayer has no choice concerning the disposal. It is only equitable for the CGT provisions to provide relief in these circumstances to ensure, as far as possible, that the taxpayer remains in the same position after the involuntary event occurs.

Superannuation

Pooled superannuation trusts are an important part of the superannuation system. They are 'wholesale' vehicles which provide significant administrative and investment economies of scale. Their unitholders are all entities within the superannuation system, such as complying superannuation funds and approved deposit funds. Along with complying superannuation funds and approved deposit funds, they are subject to extensive prudential regulation under the Superannuation Industry Supervision Act. PSTs should continue to be taxed on their current basis at 15% given that investment in these vehicles is limited to taxpayers who themselves are subject to a 15% tax rate. The imposition of deferred company tax on PSTs would in all circumstances create tax refunds. It would have a detrimental impact on the benefits of millions of superannuated workers. There does not appear to be any business case for a change in the tax treatment of PSTs, particularly given their important role in providing risk aggregation and pooling advantages to the smaller participants in the superannuation industry.

Life Insurance Policyholders

The FPA agrees that transitional measures are required if there is to be a change in the tax treatment of bonuses paid on life insurance companies. Existing life insurance policyholders should receive full grandfathering of the present tax treatment, including retaining the present 39% rate of tax rebate. Individuals acquiring policies on or after 1 July 2000 should be assessed for taxation purposes on the life insurance bonuses in the year the taxpayer receives or becomes entitled to the bonus.

Please do not hesitate to contact me if you require more information or explanation of the above matters.

Yours sincerely

Michael F McKenna

Chief Executive
Financial Planning Association of Australia Ltd

Appendix 1

Taxation of widely held trusts

Background

The FPA supports the proposal for widely held trusts to continue to be taxed on a flow through basis. Public trusts provide access for small investors to a wide range of investments including equities, property, fixed interest and cash. By pooling their investments in public trusts, small investors (such as retirees) are able to obtain access to investment expertise, risk diversification and higher rates of return. Public trusts are quite different from discretionary trusts and family trusts in that public trusts are simply a convenient and efficient mechanism for the pooling of investments that currently provide a taxation treatment broadly equating with direct investment. Given the nature and function of public trusts it is appropriate for this taxation treatment to continue.

The public trust industry consists of a number of different types of trusts, such as Retail Trusts and Wholesale Trusts. Retail Trusts refers to trusts which predominantly issue their units directly to the individual end investor. The Retail Trusts may decide to invest some of the funds received directly, or alternatively, they may invest the funds by way of acquiring interests in intermediary trusts, like Wholesale Trusts, which are perceived to have greater expertise in undertaking a particular form of investment.

Wholesale Trusts normally have a minimum subscription amount of at least $500,000 that enables the trust to achieve certain efficiencies and minimise administrative costs. These efficiencies are reflected by the lower fees charged by Wholesale Trusts.

Individual investors would not normally be able to access investment in a Wholesale Trust because of the minimum subscription amount required. These benefits can be accessed where the funds of individual investors are pooled in a Retail Trust, which then invests in a Wholesale Trust.

It can be seen that Wholesale Trusts constitute an integral part of the public trust industry. The trusts fully distribute their income on an annual basis and do not provide any tax deferral opportunities. The trusts are in fact widely held (referring to the interests of the ultimate investors) notwithstanding that immediate ownership may be concentrated within a small group of entities. This is because such entities are themselves widely held, including Retail Trusts, complying superannuation funds and PSTs.

Submission

It is submitted that flow-through taxation must be retained for all trusts in the public trust industry. Concentration of ownership should not preclude a public trust from being widely held provided that the immediate owners of the trust are themselves widely held entities.

The concept of widely held must be sufficiently defined to include trusts where the owners are entities such as other widely held trusts, complying superannuation funds, pooled superannuation trusts and life companies. This could be achieved by deeming a trust to be widely held where, say, 75% of the trust is held by other widely held entities.

Master Trusts/ WRAP Accounts

Background

These terms refer to products which have been developed to combine custodial/nominee services with investment administration services. The investor in these products normally has absolute beneficial interest in the investments of the underlying trust. Essentially, the product represents an investment administration service using a trust as the legal vehicle. The services include consolidated tax and financial reporting of the investment portfolio, execution of buy and sell orders and access to investment research and information. The individual investors are also provided with access to Wholesale Trusts.

The purpose of investors in entering into these products is to significantly reduce the burden of administration, settlement and reporting of an investment portfolio. The investor retains absolute beneficial interest in the income and capital of the trust and therefore has real economic ownership of the trust property.

Submission

It is submitted that in the circumstances set out above the trust relationship should be ignored. That is, all acts of the trustee should be treated as those of the beneficiary and the investors should therefore be treated as owning the property directly.

Taxation of tax preferred income

Background

One option raised in the discussion paper suggests that tax preferred income of widely held trusts should be subject to tax even where the flow-through concept applies. It has been mentioned earlier that the function of a public trust is to provide individual taxpayers with capital aggregation and risk pooling benefits that would not be available if the individual made direct investments. The trusts are widely held, distribute profits fully and offer managed portfolio investments.

Public trusts are not a tax deferral vehicle; they merely attempt to provide individual investors with pooling benefits that would not arise from direct investment. Such vehicles should be taxed on a flow-through basis ensuring that the individual is subject to the same tax treatment that would arise had they invested directly in the pooled investments.

The reasons set out above should apply to all trust income, including tax-preferred income. That is, tax preferred income should retain its character in the hands of the underlying investors rather than being subject to tax. This issue will be of major concern in relation to property trusts.

Investing in property through a public trust is not a tax deferral mechanism. Rather, it is comparable to the tax position of an individual holding property directly. Many individuals desire some exposure to property investment in order to ensure they have a balanced investment portfolio. Access to direct property investment is beyond the means of many investors, in which case investing through a property trust is the only means of obtaining some exposure to the property industry. Further, property investments are attractive to retirees given the constant yield and strong cash flows which generally apply over long periods of time.

Property trusts do not undertake an active business. The trustee passively holds the property on behalf of the trust beneficiaries and appoints a property manager to undertake all management responsibilities. The property manager manages the property on its own behalf. This situation is no different to a number of individuals directly owning a property and permitting a property manager to run the property. Further, there are existing provisions in the Tax Law (Division 6C of the Income Tax Assessment Act) which apply to trusts carrying on an active business. These provisions do not currently apply to property trusts and there is no reason why property trusts should now be considered to be carrying on an active business.

The tax-free and tax deferred distributions from property trusts, which mainly comprise building allowance and depreciation, can be likened to the tax deduction available to an individual holding a property directly. Just as that individual is subject to tax on depreciation recoupment on disposal of the property, so the unitholder is subject to tax on these amounts upon disposal of an investment in a trust. If such distributions were to become subject to tax, the effect would be that investors holding property through a trust would be denied deductions for building allowance and depreciation, where such deductions would be available had they invested directly in property. This clearly prejudices investors who are forced to invest via a trust rather then directly because they do not have sufficient capital to make a direct investment.

Submission

It is submitted that tax preferred income should retain its status when it flows through a widely held trust. The taxation of tax preferred income would create a difference between direct property investment and investment via a passive property trust. This would distort investment decisions and prejudice investors who have insufficient capital to invest directly in property.

Without prejudice to the comments above, if it is ultimately decided to subject tax preferred distributions to tax, the distribution should be taxed in the hands of the recipient and not taxed by way of deferred company tax. The deferred company tax system would not operate efficiently where the majority of the trust distribution is not subject to tax (but rather flows through the trust) and it is merely tax-preferred distributions that would be subject to deferred company tax.

Flow-through tax treatment of widely held trusts

Background

It has been proposed that widely held trusts should continue to be taxed on a flow-through basis and will be required to distribute all, or substantially all, their income on an annual basis. In order for this flow-through concept to operate efficiently there is no need for a "profit first" or "slice rule" to apply in respect of widely held trusts.

The slice rule may be able to operate effectively in relation to companies provided there is a relatively stable capital base and capital reductions or issues are relatively uncommon. These characteristics are not consistent with the public trust industry and consequently the slice rule cannot operate efficiently in this industry. Additionally, investors in companies are able to trade their shares with other investors in the market (in which case the slice rule will not apply). Investors in trusts are normally required to redeem their units with the trust in which case the slice rule would always apply.

The reference above to the distribution of "substantially all" income refers to the fact that widely held trusts seek to distribute all taxable income to unitholders as otherwise the trustee is required to pay tax at punitive rates. In circumstances where errors arise in calculating taxable income at distribution time, the failure to distribute the correct amount to unitholders can give rise to inequitable consequences. A reference to "substantially all" taxable income would reflect the intention of the trust to distribute all taxable income but would allow for the possibility of inadvertent error.

Submission

For the reasons set out above it should be confirmed that neither the profit first nor the slice rule will apply to widely held trusts.

Appendix 2

Discretionary Inter Vivos and Testamentary Trusts

Background

The FPA does not object to the broad notion of applying the entity tax regime to income distributed by discretionary trusts, whether established inter vivos or under the will of a testator.

However, the FPA is greatly concerned at the potential impact upon non-income amounts either distributed or made available from such trusts (for example, loans to family members, capital distributions upon winding up, etc.). These concerns arise mainly by reason of the extremely wide definitions of "dividend" and "distribution", the very narrowly defined concept of "contributed capital", the potential application of the "profits first" rule, the extremely wide concept of "resettlement" and the interaction with the FBT rules.

In particular, in applying the entity tax regime to these trusts the FPA considers that it is not valid to ignore the fundamental distinction between such trusts and corporate structures. The latter originated from a desire to enable promoters to raise capital from an arm's-length public and it was therefore necessary to insert protections and disincentives against abuse of the corporate structure in both the corporations and taxation laws in order to safeguard the investing public.

On the other hand, unlike unit trust structures, discretionary inter vivos and testamentary trusts are pre-dominantly vehicles established by families for family succession and asset protection purposes. For example:

(a) A professional person concerned about his personal exposure to professional negligence claims arising out of his practice may seek to transfer all his assets (including the family home) to or acquire new assets via an inter vivos discretionary trust. The trust would then make its assets available for the use of the professional person and his family.

(b) A parent who wishes to assist their child to purchase his first home, but is concerned that a marital or de facto relationship the child is in may break down in the near future, may be able to provide a cash sum out of an inter vivos discretionary trust by way of interest free loan to assist the purchase of the home, thereby protecting the sum in the event of such a break down.

(c) A testator who is concerned that his surviving spouse may re-marry after his death and then split up with her future partner with the possible result that all or part of her inheritance from him winds up in the hands of the future ex-spouse, may be able to provide for his surviving spouse whilst avoiding such risk by having all his assets passing to a discretionary testamentary trust.

(d) A person wishing to make a loan from his family trust to a cousin who is not currently included in the class of potential beneficiaries is added as a non-default, purely discretionary beneficiary for this purpose.

Each of the above is a common example of a trust legitimately making available its capital for a family-oriented, non-tax avoidance purpose. However, in each of these examples, there is the possibility either that the benefit provided from the trust will be liable to tax (either as deemed income or as a taxable fringe benefit) in circumstances in which tax avoidance is clearly not the underlying motive, or that the trust is treated as having been "resettled" with possible capital gains tax consequences.

The FPA considers that it is not necessary to apply the entity tax regime in such a draconian manner to what are essentially family succession and asset protection vehicles. This particularly applies to discretionary testamentary trusts, given that they can only be established by reason of the death of a person. It is strongly submitted that the desire to maintain simplicity of tax administration is in these circumstances clearly outweighed by the need to maintain equity in its application to these trusts.

Submission

The definitions of "dividend" and "distribution", the concept of "contributed capital", the application of the "profits first" rule, the extremely wide concept of "resettlement" and the interaction of the entity tax regime with the FBT rules must be re-considered, amended, etc. for the purpose of ensuring that the legitimate use of discretionary inter vivos and testamentary trusts as family succession and asset protection vehicles is not penalised.

Appendix 3

Amendments to CGT

Background

The FPA applauds the broad policy announced in the discussion paper to ease the burden of CGT. In recent years there has been a boom in individual share ownership, particularly by "mums and dads". This boom is largely attributable to a number of high profile floats, including AMP, Qantas and Commonwealth Bank. Easing the burden of CGT would promote greater share market activity and would also be conducive to creating further efficiencies in the operation of the share market. Both these factors would contribute towards Australia's push to become a financial services centre.

The FPA supports the proposal to cap the tax rate applying to capital gains derived by individuals at 30%. In order to promote simplicity within the tax system, the ordinary personal income tax rates should continue to apply up to 30%. In these circumstances, the proposal would benefit *all* taxpayers and not just those who would otherwise be subject to tax on their capital gains at rates above 30%.

The FPA supports the proposal to reduce the corporate rate to 30%. This proposal would ensure that capital gains derived by a company are taxed at the same rate as the highest marginal rate applicable to capital gains derived by individuals.

The proposal to adjust the CGT rates should not affect capital gains derived by widely held trusts that flow through to beneficiaries. As mentioned in appendix 1, the FPA strongly supports the retention of the flow-through concept for widely held trusts and retention of the character of income amounts flowing through the trusts. The proposal should also not affect capital gains derived by complying superannuation funds that would continue to be taxed at 15%.

Submission

The proposal to cap the rate of CGT at 30% and apply the personal tax rates below this percentage is supported.

Scrip - for - Scrip rollover relief

Background

The proposal to provide rollover relieve in a scrip-for-scrip takeover has been long awaited. The FPA agrees that the allowance of such rollover relief will facilitate the development of a more efficient business sector in Australia through having a more efficiently functioning domestic capital market. The absence of such rollover relief at present is clearly a barrier to the efficiency of takeovers based wholly on scrip-for-scrip, as was recently evidenced by the AMP takeover of GIO.

The absence of such rollover is also inequitable because it imposes a CGT liability upon shareholders that have no option but to receive share scrip if they wish to accept the takeover proposal. The inequity is even greater where certain shareholders would prefer not to sell (in order to avoid realising a capital gain) but are effectively forced to do so through fear of being locked into a minority situation or because the compulsory acquisition provisions could be invoked. In both situations any unrealised capital gains will become realised and the shareholder will either be forced to find additional cash to fund the tax liability or to sell down part of their shareholding to generate the requisite cash. Forcing a shareholder to reduce their equity investments merely due to a scrip-for-scrip takeover will not promote increased share market activity.

The FPA realises the need to specify the situations in which scrip-for-scrip rollover relief would be available. Any such rollover relief should apply to publicly listed companies and the relief should apply to any takeover where the acquirer is a publicly listed company, even if the target company is not publicly listed provided it will become a wholly listed subsidiary of the listed company after the takeover. Rollover relief should also be given to mergers of non-listed widely held trusts and superannuation funds.

A simple example to justify the need for such rollover relief would be where a scrip-for-scrip corporate takeover forces the consolidation of two superannuation funds. The consolidation would generally arise to provide greater efficiency and investment services to the underlying employee members of the funds. As such, the consolidation proposal should not be discouraged merely because of the fact that a tax liability would arise upon consolidation. There are clear equitable reasons why rollover relief should apply in these circumstances. Another example would be where a superannuation fund decides to invest all its assets in a PST. In these circumstances there can effectively be a “rollover” of the underlying investments of the superannuation into the PST and the transaction should be provided with concessional rollover relief. Non-listed widely held trusts should be provided with rollover relief in merger situations that are identical or similar to mergers of publicly listed companies.

Scrip-for-scrip CGT rollover relief should also be granted to corporate deconsolidations. It is also submitted that CGT rollover relief should be provided for cash mergers/takeovers of listed companies where the cash proceeds are reinvested in other listed shares.

Submission

The proposal to provide scrip-for-scrip rollover relief is strongly supported and should apply in the following situations:

- Corporate mergers where the acquirer is a publicly listed company
- Mergers of superannuation funds
- Mergers of widely held trusts
- Scrip-for-Scrip deconsolidations

Consider providing CGT rollover relief for cash takeovers/mergers of listed companies where the cash proceeds are reinvested in other listed shares.

Averaging/Indexation

Background

Individual taxpayers are able to average their capital gains to reflect the fact that taxing all gains in one year would push certain taxpayers into higher tax brackets for that year. The FPA strongly supports the need for averaging particularly given that the concession is only available to individuals who are subject to tax at less than the highest marginal rate (eg "mums and dads").

In addition, however, the FPA believes that the degree of relief provided by averaging should depend upon the length of time that the relevant asset has been held by the individual. In other words, averaging should be determined by reference to the term of the investment with no arbitrary time limits (such as the current five-year rule). This modified averaging rule would be of benefit to individuals holding assets for more then five years but would restrict the averaging benefit available to individuals holding assets for less then five years (when compared to the current averaging rules). This modified averaging rule would also eliminate the need to introduce a stepped rate of CGT which has been proposed to allow lower CGT rates on gains from assets the longer the asset was held.

If the CGT rate is capped at 30% and averaging were to be calculated over the term of the investment as proposed above, then it may be possible to remove the capital gains indexation concession without undue hardship occurring to lower-income taxpayers. Without these changes however, the removal of indexation concession would be of great detriment to individual taxpayers, particularly those in the lower tax brackets who would receive no benefit from a 30% capped CGT rate.

Submission

Consideration should be given to modifying the averaging rule such that averaging is determined by reference to the period of time the asset has been held.

CGT losses

Background

While the FPA understands the rationale for quarantining capital losses, such treatment is definitely a source of bias against risk taking and does impact unfairly on certain taxpayers who cannot use capital losses in the short term, if at all. The FPA proposes that CGT losses should continue to be quarantined for a period of five years, at which time taxpayers should be entitled to offset the losses against any income (ie revenue income or capital gains). This five year period is proposed as a reasonable balance between ensuring there is no undue loss to the revenue (which could arise if taxpayers realised capital losses and were permitted to offset them immediately against ordinary income) yet at the same time not permanently penalising taxpayers who do not have capital gains to offset against the realised capital losses. Such taxpayers would, after the five-year period, be able to offset the capital losses again ordinary income.

Submission

Realised capital losses should remain quarantined for a period of five years, after which time losses could be offset against ordinary income in addition to realised capital gains.

If the CGT rate is capped at 30% and a modified averaging rule is introduced then it would appear possible to remove the indexation concession. If averaging is removed then the indexation concession should be retained as the 30% capped rate does not provide any benefit to taxpayers in the lower tax brackets (ie taxpayers deriving income of less than $50,000, assuming the proposed reductions in personal income tax apply.)

Appendix 4

PSTs/Superannuation

Background

Small business operators use PSTs as pooling vehicles that access wholesale investments. These vehicles provide investors with the benefits of capital aggregation, risk pooling and investment expertise. Small superannuation funds would not otherwise be able to access such wholesale investments and would therefore be deprived of the cost efficiencies and expertise that can exist in such products.

PSTs are a unique form of unit trust which are specifically designed to only accept investments from entities that are subject to tax at the rate of 15% or are exempt from tax. If PSTs were to be subject to entity taxation the result would be additional tax being paid by the PST in circumstances where that tax must <u>in all cases</u> be refunded to the PST investor given that the investor is taxed at the rate of 15%.

Submission

The tax treatment of PSTs should continue on the current basis and the general rate should remain at 15% given that all the underlying investors are subject to tax at that rate.

Appendix 5

Life insurance policyholders

Background

The FPA agrees that transitional measures will be required if there is to be a change in the tax treatment of bonuses paid on life insurance policies. The FPA considers that there should be full grandfathering of the tax treatment applicable to life policies in force prior to 1 July 2000. Grandfathering is raised as an option in the Committee's second discussion paper. The option suggests that if a life policy is held for more than 10 years, the policyholder would not be taxed on reversionary bonuses paid on the policy. If the policy was held for 10 years or less, then some part of the reversionary bonus (and all of the reversionary bonus if the policy was held for 8 years or less) would be included in the policyholders assessable income and the policyholder would be entitled to a rebate. The rebate would continue to be at the current rate of 39% in relation to amounts accumulated up to 30 June 2000, however, it is proposed that the rebate should be reduced to the company tax rate on amounts accumulated after 30 June 2000.

The FPA agrees with the notion of grandfathering however it is submitted that the rebate should continue at the rate of 39% in respect of amounts accumulated after 30 June 2000. Individuals who have invested in existing life policies would have taken into account the 39% rebate when deciding to invest in the policies. These individuals should not be penalised merely because of a change in tax law which has occurred after their investment decision has been made, particularly when the individual may be further penalised if forced to make an early exit from the investment. In addition, the proposal to limit the rebate to the company tax rate applying at the time the bonus accrues would force life companies to maintain significant records concerning the amount of bonuses accruing at a particular date in respect of each policy and the applicable corporate tax rate at that date. This would require significant IT changes with accompanying high levels of cost.

In relation to policies issued on or after 1 July 2000 the FPA supports the proposal for individuals to be assessed on life insurance bonuses when the individual receives or becomes entitled to the bonus. The policyholder would pay tax at the relevant marginal tax rate in the year of receipt/entitlement to the bonus. The FPA does not consider that policyholders should be entitled to elect to be assessed annually on the bonuses assigned in a year in lieu of being assessed at the time the taxpayer receives or becomes entitled to the bonus. The election would require life insurance companies to administer two different tax compliance systems that would only involve unnecessary additional compliance costs. It is considered preferable for the amount to be assessed at the time the individual receives or becomes entitled to the bonus, at which time the individual should have the funds available to pay the income tax liability.

Submission

Existing life insurance policyholders should receive full grandfathering of the present tax treatment, including retaining the present 39% rate of tax rebate. Individuals acquiring policies on or after 1 July 2000 should be assessed for taxation purposes on the life insurance

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