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Our Reference JKM 1217173  
Writer's Direct Line (02) 9230 4953  
Partner Responsible John Morgan

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15 April 1999

The Secretary  
Review of Business Taxation  
Department of The Treasury  
Parkes Place  
CANBERRA ACT 2600

Dear Sir

### **EQUITAS LIMITED - TAXATION OF TRUSTS - TRUSTS REQUIRED BY LAW**

We act on behalf of Equitas Limited, a company incorporated in England and established for the purposes of the Lloyd's Reconstruction and Renewal Settlement in June 1996. Equitas Limited is the ultimate reinsurer of what is known as 1992 and prior business of Lloyd's pursuant to reinsurance arrangements with Lloyd's underwriters.

Following upon these arrangements, negotiations have proceeded with the Australian Prudential Regulation Authority and its predecessor, the Insurance and Superannuation Commission to change the regulatory arrangements relating to Lloyd's underwriters in Australia. That has led to the passing of the Insurance Law Amendment Act 1998 which introduced into the Insurance Act 1973 a proposed new system of regulation for Lloyd's underwriters in Australia. That legislation has not been proclaimed to commence at this stage and its commencement depends upon the establishment of certain trust funds in Australia which will hold assets to support the Australian liabilities.

Under the new arrangements, Lloyd's will be required to ensure that there are in existence security trust fund arrangements under which final judgments obtained in Australia against Lloyd's underwriters in respect of certain insurance liabilities may be satisfied out of the trust property. These trust funds, referred to as designated security trust funds, will provide security in the event of a failure to make a payment under relevant policies.

For this purpose, Lloyd's are establishing a number of trust funds and we believe that Lloyd's have made a separate submission to you in relation to this matter.

Equitas Limited has also agreed to establish a trust fund in Australia in respect of the reinsured Australian policies.

#### **Tax law implications**

These new arrangements involving designated security trust funds in Australia have been under discussion with the Government for some considerable time and Equitas Limited has proceeded on the basis that the tax treatment of the trust fund established by it would be under current tax law. If there is any prospect that the trust fund would not be taxed in this way, then the proposed new arrangements would need to be thoroughly reconsidered and it is unlikely that they could proceed in their current form.

#### **A platform for consultation**

At paragraph 22.1 of Discussion Paper 2 "A Platform for Consultation" it is stated that the proposed new entity tax system would apply to all resident trusts unless they are specifically excluded". At paragraph 22.2 it is stated: "The general principle for exclusion proposed in *a new tax system* is that trusts which have been created or settled only as a legal requirement or subject to a legal test or sanction could be excluded. This principle is aimed at those trusts where the beneficiary (and the settlor or parent or guardian) would not usually have any real say in the use of a trust structure. This principle distinguishes such trusts from trusts created at a settlor's direction. Appendix A lists those trusts that could be excluded from the new entity tax system on the basis of the general principle".

Appendix A lists various trusts that fall within the category which may be excluded.

### **Submission**

In our view, the designated security trusts established under Part VII of the Insurance Act 1973 following the proclamation of the Insurance Laws Amendment Act 1988 are trusts required by law. Once the legislation is proclaimed, in order for Lloyd's to continue to operate in Australia, it will need to have in Australia security trust funds approved by the Commissioner. By section 67(1) the trust property of these funds is available to satisfy final judgments obtained in Australia against Lloyd's underwriters in respect of a class of insurance liabilities specified in the Trust Deed. The terms of the trust funds must be approved by the Commissioner and must meet the other requirements of the legislation.

In certain events, the Commissioner is entitled to appoint a judicial trustee to better secure the trust assets and there are arrangements for the ultimate distribution of trust assets by a court approved scheme of arrangement if there is relevant default.

In the case of Equitas Limited, it proposes to establish the Equitas Australian Trust in relation to Australian policies reinsured by Equitas.

The trusts are required under the new legislation to maintain assets equal to specified minimum amount and there is a process of regular rebalancing of those assets. The minimum amount is an amount ultimately approved by the Commissioner under the legislation as being an amount to secure the Australian liabilities.

In our view, these trust arrangements are trusts required by law and in accordance with the general principle outlined above they should be excluded from any proposed entity tax regime.

Moreover, we believe that tax treatment of these trusts should not alter from the current tax treatment which is accorded to them under the Income Tax Assessment Act 1997 and the Income Tax Assessment Act 1936.

If you require any further information please advise.

Yours sincerely

**JOHN K MORGAN**