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15 April 1999

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

Dear Sir

SUBMISSION: A PLATFORM FOR CONSULTATION

Suncorp~Metway Ltd is pleased to take the opportunity to provide a brief submission in response to certain options raised by the second discussion paper ("a Platform for Consultation") produced by the Review of Business Taxation.

The need for far-reaching tax reform that results in international competitiveness, flexibility and equality is immediate. The work undertaken by the Committee to date has succeeded in focusing the community on the options available to meet this need. The committee is to be commended for its work.

In this submission, we have limited our review and comments on those issues in the discussion paper which are materially relevant to our business. We have not commented on issues affecting leasing, but support the position adopted by the ABA in relation to this area.

To establish the context of the submission, Suncorp~Metway Group is a financial services conglomerate providing banking, general insurance, life insurance, superannuation, funds management and related services to a predominantly Australian domestic customer base. Suncorp~Metway Limited, the group holding company, is a publicly listed company, whose shareholders are predominantly Australian resident. A corporate group structure is attached for your reference.

In considering the options raised in the discussion paper, we have been cognisant of the impact on both the business and its shareholders.

Yours sincerely

A J Hogendijk
Chief Financial Officer

Suncorp~Metway Ltd
Submission: a platform for Consultation

Executive Summary

The main points of our submission are as follows. These positions are supported in detail in the body of our submission.

Collective Investment Vehicles ("CIV")

- The definition of CIV must be clearly set, so as not to disturb the tax status of existing passive investment vehicles.
- The tax treatment of tax preferences in relation to existing investments should be grandfathered.
- The taxation consequences of trust deed/constitution alteration to adopt tax reform must be clearly established in consultation with Industry.
- The existing taxation treatment of unit redemption must be retained, as opposed to applying the "profits" first or "slice" approach.
- The current taxation treatment and rate of Pooled Superannuation Trusts ('PST") should be retained.

Life Insurance

- The taxation of existing issued life insurance products should be grandfathered, in consultation with Industry.
- Life company specific reforms should be delayed until GST and all other tax reforms are implemented.
- The ability to transfer tax liability from superannuation funds to life companies or PST's should be retained as a compliance saving.

Consolidation

- Existing grouping abilities should remain available if consolidation is not elected.
- Consolidation will not reduce the compliance burden for financial conglomerates. A delay in its introduction should be considered, to allow the successful implementation of GST and other tax reforms by organisations.

Taxation of Financial Assets and Liabilities

- We agree that taxation of mark to market should not be mandatory.
- Existing anti-avoidance provisions address manipulation concerns – there is no need to expand loss quarantining.
- Rules for the debt/equity distinction must take into account the international competitiveness of Australian enterprises.

Entity Taxation

- We do not support the deferred company tax option or taxation of unfranked intercompany dividends.

Profit & Capital Distributions

- Full capital treatment should be allowed for share buybacks and cancellations, where that is the intention of the shareholders.

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REVIEW OF BUSINESS TAXATION

A PLATFORM FOR CONSULTATION

Comment on Options presented

1. An alternative treatment for collective investment vehicles

Distributing Trusts

Suncorp~Metway Group acts as investor in and manager of a large number of unitised investments. These investments are held through wholesale and retail unit trusts, pooled superannuation trusts and other like investment vehicles. Direct investment on behalf of policyholders, shareholders and customers occurs in these vehicles.

The second discussion paper proposes, with certain exceptions, the consistent taxation of entities, by adopting the company tax regime in determining taxation obligations. It has been acknowledged that this is a fundamental shift in the taxation of investment and will impact after-tax returns to investors.

The exceptions are identified as "Collective Investment Vehicles" (CIV). The Suncorp~Metway Group requires resolution of a number of key issues in relation to the taxation of CIV's to achieve understanding and certainty of taxation obligations. Unless certainty is delivered, fully informed investment decisions, on behalf of all stakeholders, will not be possible.

The key issues are:

- **Definitional**

"Full flow-through of annual profits"

> Compliance with this requirement must be determined by reference to the income definition policy adopted by the constituent document. At the very least, the existence in the Trust Deed of the requirement on the trustee to distribute the taxable income of the trust to its beneficiaries must be established as meeting these criteria.

"Passive Income"

> It must be recognised that the nature of true CIV's is the undertaking of passive investment. This is supported where there is a requirement in the Trust Deed for a full flow-through of profits. Investments made by the CIV's must be examined on their merits to determine compliance with the derivation of "passive income". For example, investments in shopping centres and hotels – is not "trading" or active income – the CIV is not carrying on the tenants' businesses. Rather it is investing to derive a rental stream from a substantial capital asset.
>
> We suggest that the existing rules contained in Division 6C of the 1936 Act are appropriate to determine whether a CIV be allowed flow-through treatment.

"Widely held"

CIV's presently invest in other investment vehicles that are undertaking passive investment in order to achieve targeted investment returns, portfolio diversification, hedging, etc. These structures include joint venture trusts and sub-trusts. Examples of the former are:

- Suncorp~Metway owns an interest in a Sydney CBD office building together with a Westpac property trust
- Suncorp~Metway also has a 50% interest in a Cairns shopping centre with Coles Myer

An example of the latter would be where a retail trust, subscribed to by "mum and dad" investors, invests in a wholesale trust that has been established to hold a class of assets with specific return features (eg Australian Shares yielding assets and capital growth). The wholesale trust has a limited number of investors due to the minimum investment thresholds that are standard in the Industry.

The conduit nature of the wholesale trust should be recognised by allowing tracing to ultimate natural persons to determine the "widely held" nature of these type of sub-trusts.

To illustrate the necessity of permitting tracing through tiered trust investments, attached as Appendix 2 is the Suncorp~Metway property trust structure. The investments (in trusts) of the Suncorp Balanced Property Fund, and the fund itself, are vehicles for passive investment that distribute, as a minimum, taxable income each year. These distributions flow through the tiered trusts to a variety of investors, corporate, superannuation fund and natural person.

Appendix 2 also illustrates the joint venture arrangements entered into by Suncorp~Metway where necessary to secure shopping centre infrastructure investment.

- **Tax treatment of tax preferences**

Retrospective Taxation

Any change to assessing tax-free distributions (most commonly due to Division 10C and 10D building allowance) amounts to retrospective taxation. A consequence of this is the suggestion that the Australian taxation system is not stable and does not provide a reliable basis for the making of investment decisions. Consideration must be given to grandfathering those existing investments that receive the benefit of a tax incentive resulting in a tax-free return. The incentives have a limited life and will pass through the tax system over time.

Taxpayer Discrimination

The view that tax preferences of CIV's should be taxed on distribution in our view adopts the wrong benchmark for consistent taxation. The emphasis has been placed on the replication of corporate taxation across non-corporate entities. The distribution of tax preferences by companies is presently achieved by way of unfranked dividends. In the case of the ultimate individual shareholder, these are then assessed in the hands of the shareholder. Pursuant to the options provided under Chapter 15 of the discussion paper, these distributions will be subject to taxation at the entity level.

If an individual shareholder held the tax-preferred investment directly, the tax preferences in most cases would be realised by the individual. **We submit that the taxation impact on the individual is the correct benchmark for investments through CIV's in passive investments**. This is in accordance with the neutrality principle.

Individual investors invest in CIV's to obtain, through a pooling of funds with others, an exposure to investments (eg property) that would otherwise be unaffordable. It is inequitable to deny concessions to Australian taxpayers (eg retirees) on the basis that they cannot afford a direct investment.

- **Taxing Point**

As a technical matter, where trusts are taxed as companies, beneficiaries must be taxed at the time the distribution is made, not at the time they become presently entitled. This is consistent with the concept of uniform entity taxation and addresses a cash flow issue in the hands of the beneficiary.

- **Alteration of Trust Deeds**

Trust Deed amendments and resettlement, and the possibility of investment restructuring to achieve pre-committed investment returns, will be required to cope with change in taxation. The issue is also relevant presently in relation to amendments required by the Managed Investments Act (MIA). To avoid industry uncertainty, the taxation consequences of Trust Deed Amendments must be publicly settled through consultation with Industry. While we welcome the announcement of "whole of Act" relief in respect of deed changes to comply with MIA, in our view the MIA press release was based on an incorrect view of the income tax law in relation to changes to trust deeds.

- **Redemption of units**

Certainty must be established in relation to the taxation of the redemption of units in a CIV. It must be made clear that the "profits first" model and "slice" approach do not apply to redemptions of CIV units where a redemption receipt does not include a right trust income. Further, CIV's usually permit individual unitholders the right to redeem at any time. Accordingly, a change from the existing taxation treatment of unit redemption will result in significantly higher compliance obligations.

2. Pooled Superannuation Trusts (“PST’s”)

Confirmation is required that the discussion paper erred in considering PST’s to be distributing entities. In recognition of their purpose in relation to the efficient usage of superannuation fund investment, PST’s should continue to be taxed at the superannuation fund rate.

3. Life Insurance

Grandfathering of existing taxation treatment

Suncorp~Metway Group provides life insurance services to its customers. The stability and value of the benefit acquired by these customers is directly affected by the investment returns on policy holders’ funds. A change in taxation of these returns reduces the value of the compensation already contracted to. For this reason, the grandfathering of taxation treatment of existing life insurance funds held must be considered. This will increase complexity but maintain equity.

It is imperative to consider the effect on corporate solvency if customer behaviour changes. The impact of behavioural change can be seen now in the lead up to a GST. In the context of general insurance, increased premiums as a result of GST may see customers underinsure or fail to insure at all. Beyond the economic, this has wider social ramifications. Applied to life insurance, assuming taxation of underwriting profits as well as investment income leads to increased premiums, there could be reduced cover for insured risk and that may lead to diminished take up of life cover.

Further, the impact on shareholders funds must be considered if transitional arrangements are not put in place. Change should not come at the cost of existing shareholder value.

Transitional Measures

Compliance with life insurance taxation is complex and time consuming. We welcome the opportunity to simplify our taxation compliance obligations.

It is essential, however, that the current taxation rules applying to life insurers (Division 8) be the subject of transitional rules that are determined in close consultation with the Industry. In addition, consideration should be given to delaying the introduction of amendments to taxation of life insurers and life insurance policies until the GST and wider business tax reform are bedded down. The burden on life insurance companies in implementing an input-taxed GST regime, and making systems and structural changes for business tax reform, does not allow for the resources to make the systems changes necessary to cope with the amendments foreshadowed in the discussion paper.

Superannuation business of life companies – Section 275 Transfers

At present, there is provision under S. 275 of the 1936 Act for a complying superannuation fund to transfer its liability to tax on taxable contributions to a life insurer or PST in which it invests. This mechanism is utilised most often by small superannuation funds that wish to effectively outsource taxation administration to the life offices they entrust their superannuation with.

This efficiency gain is proposed to be removed by the proposals in the discussion paper. This action must be reconsidered in consultation with Industry.

4. Consolidations & financial conglomerates

The Suncorp~Metway Group prepares detailed consolidated accounts for accounting statutory reporting purposes. However, individual entities are still required to be considered separately. For example:

- By APRA

  There are no integrated solvency/capital adequacy rules for banks and insurance companies. The difficult mix of same shareholders with different stakeholders (eg bank customers v general insurance policyholders v life insurance policyholders v creditors v statutory obligations) means that a substantial degree of separation must be maintained within the organisation.

This will probably mean that tax loss and other transfers will still need to occur for consideration and be accounted for at the company level. For us, this substantially diminishes the opportunity for compliance cost savings from a consolidated tax regime.

In view of the above, it is inequitable for a business to lose current grouping abilities and concessions if constrained from electing optional consolidation. It is quite possible that losses may exist in a current group company that would have no value if grouping were not available.

Suncorp~Metway's unique mix of banking <u>and</u> insurance products may be substantially disadvantaged in competition with other service providers if the ability to use existing grouping concessions is forfeited. A level playing field is not achieved by this option.

Further, we note that accounting consolidation is required where control of an entity is in existence. Usually this is where there is greater than 50% ownership. Considerable compliance work will be required to deconsolidate group accounts and reconsolidate for tax purposes, if different consolidation benchmarks apply.

5. Revenue assets

In the event that CGT indexation is not removed, there should be group roll-over relief for revenue assets. This will make consistent the transfer of all asset categories – capital, revenue and trading stock - within a corporate group. It is inequitable to perpetuate an anomaly that crystallises tax where beneficial ownership of the transferred asset has not changed.

6. Taxation of financial assets and liabilities

We welcome the indication that taxation of mark-to market valuations is not mandatory. The taxation of unrealised gains in certain illiquid circumstances, and in circumstances where gains may never be realised is inequitable.

Further, we suggest there should not be a mark to market regime for gains and losses on (equity) investments of insurance companies due to the cash flow and equity problems outlined above. While these assets are revenue (as opposed to capital) assets, these assets often have long term holding periods and should be clearly subject to assessment on a realisation basis.

Concerns about manipulating realisations should be addressed by existing general anti-avoidance provisions; not via expanded loss quarantining (refer para. 6.120 of the discussion paper). This suggestion is a retrograde step in simplifying compliance.

Section 46G of the Income Tax Assessment Act 1936 will need to be made consistent with the discussion paper outcomes in relation to previously assessed asset revaluations.

Debt / Equity Distinction

Particularly in relation to finance providers, it is vital that the debt/ equity distinction is clear and certain, and maintains international competitiveness. For example, international competitors of Suncorp~Metway may be able to access cheaper funds through tax-deductible capital. These forms of financing must be recognised in the tax reform process.

7. Entity Taxation

The option in relation to Deferred Company Tax ("DCT") has received widespread opposition from business. We firmly agree with that opposition, noting:

1. DCT is a charge against profits, reducing earnings per share and the valuation of companies, resulting in an increase in capital raising costs
2. DCT does not compliment Australia's double tax treaty obligations, effectively increasing the withholding tax on unfranked dividends to 36%
3. DCT may not give rise to a foreign tax credit for non-resident investors

The option to tax unfranked inter-entity distributions, achieved through the removal of the inter-corporate dividend rebate, does not take into account statutory and regulatory requirements, such as dividends paid up within the wholly owned group for capital management purposes as required by obligations under APRA.

That is, where our general insurance subsidiary company has surplus solvency it may be desirable to upstream that surplus to the bank to boost its capital adequacy. This is necessary because of APRA not yet having integrated capital measurement for "financial conglomerates". These distributions do not ultimately flow to shareholders. The potential result is taxation on the intra group dividend. Given that part of general insurance's capital management dividend may be from unrealised investment gains, tax on unrealised income may result. This is not consistent with the principles driving the taxation of financial instruments, as outlined in the discussion paper.

Further, inter-company dividends, if previously taxed, should not absorb tax losses of the shareholder company. Such an outcome would be inequitable, amounting to effective double taxation. This outcome could be avoided through allowing a dividends received deduction or income exemption.

7. Distinguishing profit and capital distributions

Present taxation rules acknowledge the right of shareholders to choose the source from which share buy-back and cancellations are made.

The options proposed by the discussion paper are the "profits first" approach and the "slice" approach. Neither of these approaches recognises that share buy-backs and cancellations are undertaken to reduce the amount of capital on issue by a company. In this situation, the transaction is entirely capital in nature, and a distribution of profits is not necessarily intended.

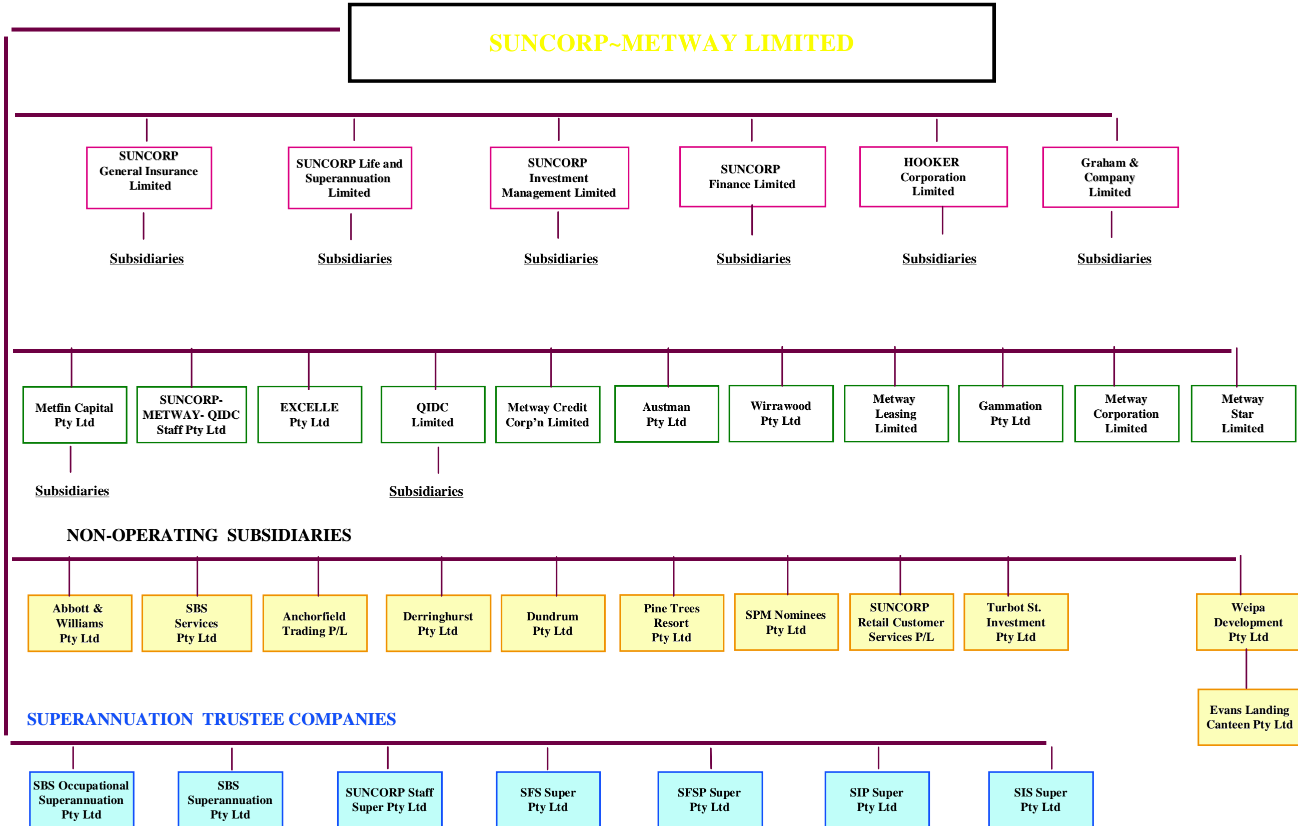
The consequence of not allowing a full capital treatment for share buy-backs and cancellations, where that is the intention of the shareholders, is to remove an established right of the shareholder in relation to its property. This is a distortion in the perceived value of the shares in the existing market.

Specific exceptions to the slice approach and profits first approach are suggested.

9. Fringe Benefits Tax

We support the view that fringe benefits tax should be levied only on benefits that are non-cash components of a salary package. The implementation of this view would greatly simplify the compliance burden, as salary-packaging information is usually centralised and easily accessed. Consistent with this outcome, the non-deductible treatment of entertainment should be reinstated.

Appendix 1



Appendix 2