22 July 2011

Mr Paul McMahon
General Manager
Business Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Mr McMahon

CGT EXEMPTION FOR CERTAIN COMPENSATION & INSURANCE PAYMENTS

The Financial Services Council (*FSC*) welcomes the opportunity to provide a submission on the proposed amendments to the CGT exemption for compensation and insurance payments. This submission is provided in response to the Proposals Paper issued by Treasury on 27 May dealing with minor amendments to the Capital Gains Tax Laws.

The FSC represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers and financial advisory networks. The FSC has 128 members who are responsible for investing $1.8 trillion on behalf of more than 11 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Stock Exchange and is the fourth largest pool of managed funds in the world. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

It is important that the CGT exemptions for compensation and insurance payments are clear and unambiguous. Therefore, the FSC welcomes and supports the measures contained in the Proposals Paper, and also provides the following reasons for supporting these measures.

CGT Exemption for Compensation Payments and damages paid to a trustee

This proposal involves extending the exemption for compensation payments and damages contained in Section 118-37 of the Income Tax Assessment Act 1997 to cover payments by insurers to trustees, other than trustees of complying superannuation entities. This measure will assist the establishment of trust structures outside superannuation to hold and administer the proceeds of disability or trauma policies for the benefit of injured or ill persons. Therefore the FSC welcomes this measure.

CGT Exemption for Certain Insurance Payments made to Superannuation Trustees

This proposal involves the extension of the CGT exemption contained in Item 5 of the Table in Subsection 118-300 to cover life insurance policies generally. At present the exemption only applies to death cover, and does not apply to other forms of life insurance held by a superannuation fund trustee.

We suggest that the definition of life insurance policy contained in the Life Insurance Act 1995 be used for the purposes of subsection 118-300. This ensures that the claim proceeds of all life insurance policies held within a superannuation environment would be dealt with under Item 5 of Section 118-300. This would remove the present anomaly of taxing the proceeds of death cover under Section 118-300, and the proceeds of total permanent disability insurance and trauma insurance under Section 118-37. In particular, the FSC considers the Item 5 exemption be extended to apply to all life insurance policies owned by the trustee of a complying superannuation fund, including salary continuance or income protection policies.

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The FSC also welcomes the proposed modification to the “CGT primary code” rule in Section 295-85. The reference to gains or losses s exempted under Item 5 in the table in Subsection 18-300 will be removed. This will ensure that CGT will be the primary code for dealing with insurance policies held by complying superannuation funds and therefore these policies will not be taxed on revenue account.

It is important to note that the above exemptions are an important mechanism to prevent the double taxation of insurance proceeds within superannuation. The claim proceeds of insurance policies within superannuation should not be reduced by taxes payable at the superannuation fund level. The claim proceeds will be distributed to the member of the superannuation fund in due course, and may be taxed in the hands of the recipient. For example, death benefits paid to a non-dependant for tax purposes will be taxed in accordance with the rules applicable to these benefits.

CGT Exemption for Insurance Policies on the life of an Individual

This proposal involves the extension of the exemption in Item 3 in the table in subsection 118-300 to cover life policies held outside the superannuation environment. At present, the exemption only applies to death cover, and does not apply to other forms of life insurance.

This would remove the present anomaly of taxing the proceeds of death cover under Section 118-300, and the proceeds of total permanent disability insurance and trauma insurance under Section 118-37. At present, the proceeds of disability insurance owned by a corporate entity or a business partner who is not related to the injured/ill party does not qualify for the Section 118-37 exemption. It is submitted that this inconsistency of tax treatment should be removed.

We suggest that the definition of life insurance policy contained in the Life Insurance Act 1995 also be used for the purposes of this section. This ensures that for CGT purposes, the claim proceeds of all life insurance policies held outside superannuation would be dealt with under Item 3 of Section 118-300. This would remove the present anomaly of taxing the proceeds of death cover under Section 118-300, and the proceeds of total permanent disability insurance and trauma insurance under Section 118-37.

Policies held on Revenue Account

The FSC also submits that the provisions in respect of insurance outside superannuation should be limited to the capital gains tax provisions only.

Owners of insurance policies should be able to claim a deduction for premiums paid by applying the general deduction provisions contained in Section 8-1.

For example, the existing practice in relation to income protection insurance taken out by an individual to compensate for loss of an income stream in the event of illness or temporary disability should continue. It has been accepted for many years that such a premium is deductible to the policy owner and any claim proceeds are assessable

Another example of a policy owner seeking to claim a tax deduction for an insurance premium paid is an employer who owns the policy on the life of a key employee where the insurance has been taken for the purpose of protecting a revenue stream generated by the a key employee for the benefit of the employer. It is accepted that the claim proceeds of a policy of this type are assessable.

The FSC considers that it is inappropriate to introduce legislation which alters the long established practice.

We thank you for the opportunity to submit on this important topic, and invite any further enquiries which might lead to developing a clear set of CGT exemptions for compensation and insurance payments.

If you have any questions regarding the FSC's submission, please do not hesitate to contact Pravin Madhanagopal or myself on (02) 9299 3022.

Yours sincerely

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Director of Policy