

27 July 2012

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

Dear General Manager

Minor Amendments to Capital Gains Tax – Proposals Paper

Thank you for the opportunity to provide comments in relation to the proposed minor amendments to capital gains tax law.

The Financial Services Council (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.

Generally we see that the proposals are positive, however we would like to comment on the particular items outlined in Appendix 1. We also note that one of our members, Equity Trustees, will submit a separate comment paper. The FSC supports these comments.

Please contact Carla Hoorweg on (02) 8235 2519 should you wish to discuss the FSC's comments further.

Yours sincerely



CARLA HOORWEG

Senior Policy Manager, Global Markets & Tax

Appendix 1

2.2 CGT EXEMPTION FOR CERTAIN INSURANCE POLICIES OWNED BY A COMPLYING SUPERANNUATION ENTITY

The above amendments are a welcome clarification to the CGT status of life insurance policies held within a superannuation fund.

The Proposal dealing with life insurance within a superannuation fund envisages that the amount received on claim by a superannuation fund would be exempt from CGT under Item 5 of Section 118-300. Item 5, at present only applies to death claims. There has always been debate about the tax status of total permanent disability claim proceeds and income protection claim proceeds.

Under the Proposal, the definition of life insurance would be expanded to match the definition contained in the Life Insurance Act plus some expansion to accommodate short term disability policies. However, it will be important to be explicit in this regard. The ATO have, on occasion, not shared the view of industry on past practices and this matter should, given the underlying policy, be put beyond doubt.

Issue – Capital/Revenue status of claims proceeds

One area that still is open to debate is the capital/revenue status of the claim proceeds. Claim proceeds within superannuation are generally accepted as being capital in nature both according to ordinary concepts and on the basis that CGT is the primary code for calculating gains and losses in a superannuation fund. (Section 295-85). Section 295-85(3) contains exceptions to the primary code rule, and these exceptions include items such as debt instruments. Unfortunately, there is a catch-all exclusion in Section 295-85(3)(b)(iv) which states “some other contract under which an entity is liable to pay an amount (whether the liability is secured or not)”.

It could be argued that insurance contracts could be brought under this exclusion, and therefore be open to the possibility of being taxed as revenue items. This would render the Section 118-300 exemption ineffective for superannuation funds.

Recommendation

The FSC suggests that Treasury insert an exclusion for life insurance contracts in Section 295-85(3)(b)(iv) to remove doubt. This would ensure that the claim proceeds are treated as capital items under Section 295-85, and exempt under Item 5 of Section 118-300.

Any tax which may be payable would be levied on the member or beneficiary receiving the funds. In certain circumstances such a tax levied on the fund could result in double taxation or inappropriate taxation where an exemption should apply.

3.1.1 AMENDING THE DECEASED'S FINAL TAX RETURN AND CGT EVENT K3: PROPOSAL TO MAKE K3 AN ESTATE LIABILITY AT TIME OF "PASSING"

The FSC agrees that amending CGT Event K3 to occur at time of passing will minimise compliance costs, for example if there is an intervening life interest and passing occurs decades after the deceased's date of death.

Issue – interaction with other Division 128 provisions

We would like to raise a technical query regarding how Treasury sees the proposed amendment interacting with other provisions in Div 128. In particular, the requirement for the tax advantaged beneficiary to become the "owner" of an asset for "passing" to occur (Section 128-20) and the fact that there is an increased likelihood that the asset may have to be sold in order for the trustee to pay the K3 liability in the estate.

Passing is predicated on the beneficiary becoming absolutely entitled. Even if the asset is considered to have passed, despite the tax advantaged beneficiary not becoming the owner of the asset due to sale by trustee, does this mean that any CGT on the sale by trustee (CGT Event A1) will be ignored because the tax advantaged beneficiary will be absolutely entitled?

Recommendation

The FSC suggests that Treasury clarify this point to remove doubt.