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Dear Sir

R&D tax incentive - Unintended adverse impacts for life insurance companies

We welcome the opportunity to comment on the Exposure Draft of the Tax Laws Amendment (2013 Measures No.2) Bill 2013: Targeting R&D tax incentive to small and medium business (***Exposure Draft***) which was released on 7 May 2013.

The exposure draft proposes to limit eligibility for the R&D concession if assessable income for a company, its connected entities and affiliates equals or exceeds $20 billion. The use of assessable income will create a structural bias against life insurance companies as it does not take into account the deemed assessable treatment of policyholder investment capital.

Life insurance companies carry on a number of businesses, including risk insurance, superannuation and funds management. Importantly, life insurance companies differ from stand-alone superannuation funds or funds management businesses in that a life insurance company will directly hold investment capital on behalf of policyholders and the receipt of that investment capital is treated as assessable income by virtue of subsection 320-15(1)(a) of the *Income Tax Assessment Act 1997 ("ITAA 1997").* By comparison, superannuation fund contributions and investment trust capital is not assessable to a registrable superannuation entity licensee or responsible entity of an investment trust.

The difference for life insurance companies arises due to the operation of Division 320, which treats all premium income as assessable and provides deductions for investment capital within premiums (e.g. sections 320-55, 320-60, 320-65, 320-75). This mechanism is appropriate for the purposes of taxing a life insurance company, as the net outcome is that a life insurer is not taxed on premiums that do not constitute its economic income. Division 320 is intended to operate on a symmetrical basis, whereby investment capital amounts that are treated as assessable are offset by equivalent deductions.

It is not appropriate to use the gross assessable income of a life insurer to determine whether it qualifies for the R&D concession as this applies only part of Division 320, giving an asymmetric outcome that is inconsistent with Division 320's legislative policy intent.

The draft legislation creates an inappropriate structural bias between life insurers and other entities that operate funds management businesses:

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- Superannuation trustees and fund managers are not assessed on contributions into a superannuation fund (a separate entity), whereas a life insurance company's complying superannuation premiums and segregated exempt asset premiums are assessable. There is no justifiable reason for this discrimination given that the business operations and economic profit fundamentals of superannuation providers are essentially the same whether under a life insurance company or not. That is, both the business of superannuation trustees/fund managers and life insurance ordinary investment/superannuation/exempt asset business pay tax on their own behalf only on fee income derived from managing assets beneficially or economically owned by others. As noted above, the mechanism built into the tax law to achieve this differs for life insurance companies from that used for trustees and fund managers. This non-risk life insurance business is not taxed on an underwriting basis.
- Investment capital received by other entities is not specifically deemed to be assessable income (e.g. listed investment companies or trusts).

Submission

It is submitted that the exposure draft legislation should contain a provision to remove this structural bias. For example, new paragraph 355-103(3) could be inserted as follows:

> "(3) An *R&D entity's amount for the income year worked out under subsection (2) does not include any amounts that:
> (a) the R&D entity;
> (b) an entity that is *connected with the R&D entity at any time during the income year;
> (c) any entity that is an *affiliate of the R&D entity at any time during the income year; or
> (d) any entity of which the R&D entity is an affiliate at any time during the income year;
>
> can deduct in that year for *life insurance premiums or *net premiums under sections 320-55, 320-60, 320-65, or 320-75."

Please contact me if you have any queries regarding the above.

Yours faithfully

Adam Gibbs
Partner