BRAD

CHAPTER 6

TAXATION OF TRUSTS, CO-OPERATIVES AND LIFE INSURERS

BRAD

Chapter 6: assessing trusts, co-operatives and life insurers

The Tax Department's tax policy team, Claudia, Brad and Sami, now have to turn their minds to preparing yet another briefing for the Tax Minister, this time on trusts, co-operatives and life insurers. During earlier briefings, the minister saw the potential benefits of achieving greater consistency of tax treatment across different investment vehicles and also said people often tell him of the need to reform the tax treatment of trusts.

Moreover, the team, or at least most of the team, are particularly excited about the briefing at hand because the Tax Minister has, in fact, foreshadowed discussing the way forward with the Prime Minister and other colleagues after this latest briefing.

Nevertheless, Claudia knows this briefing will be challenging.

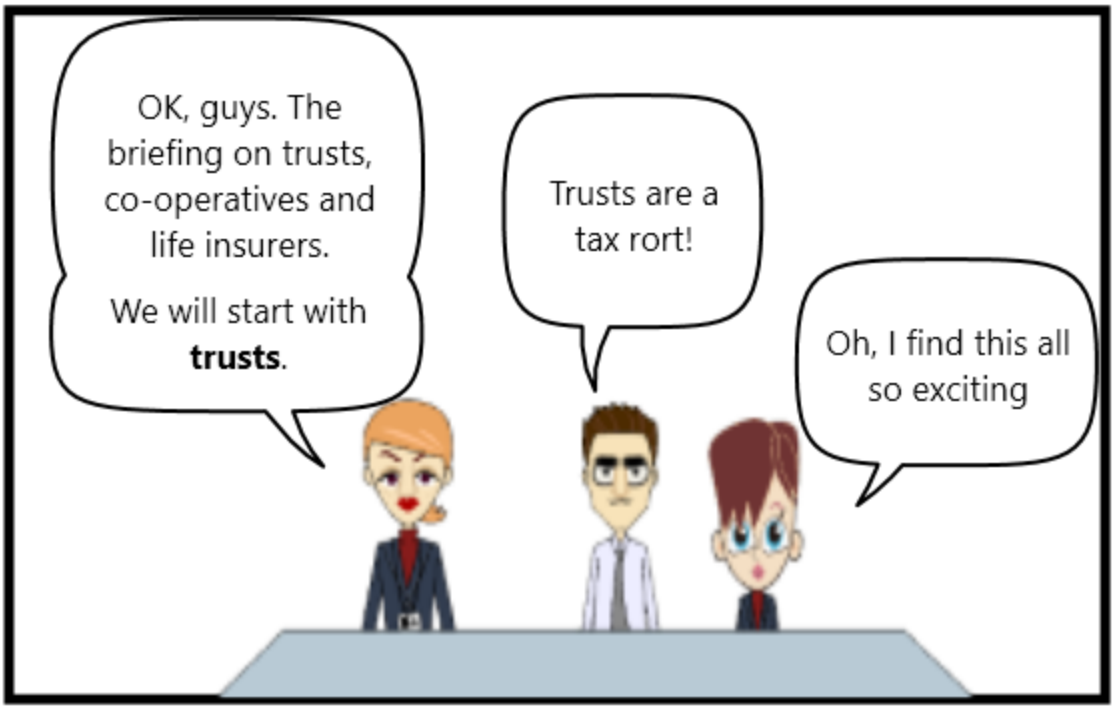
The income tax laws in the team's country are remarkably similar to those in Australia. Consequently, preparation for discretionary trusts draws, in part, from: Australian court decisions, including those relating to the Bamford case (discussed in Walpola (2020) - see Preface - along with wider implications and lots of references); expert commentary in Australia; and related government consultative papers (Australian Government, 2011). Preparations for the difficult area of foreign trusts is helped greatly by a book, Burns and Krever, which analyses Australia's tax treatment of non-resident trusts, including suggested reforms and many references, before subsequent changes were made to the law.

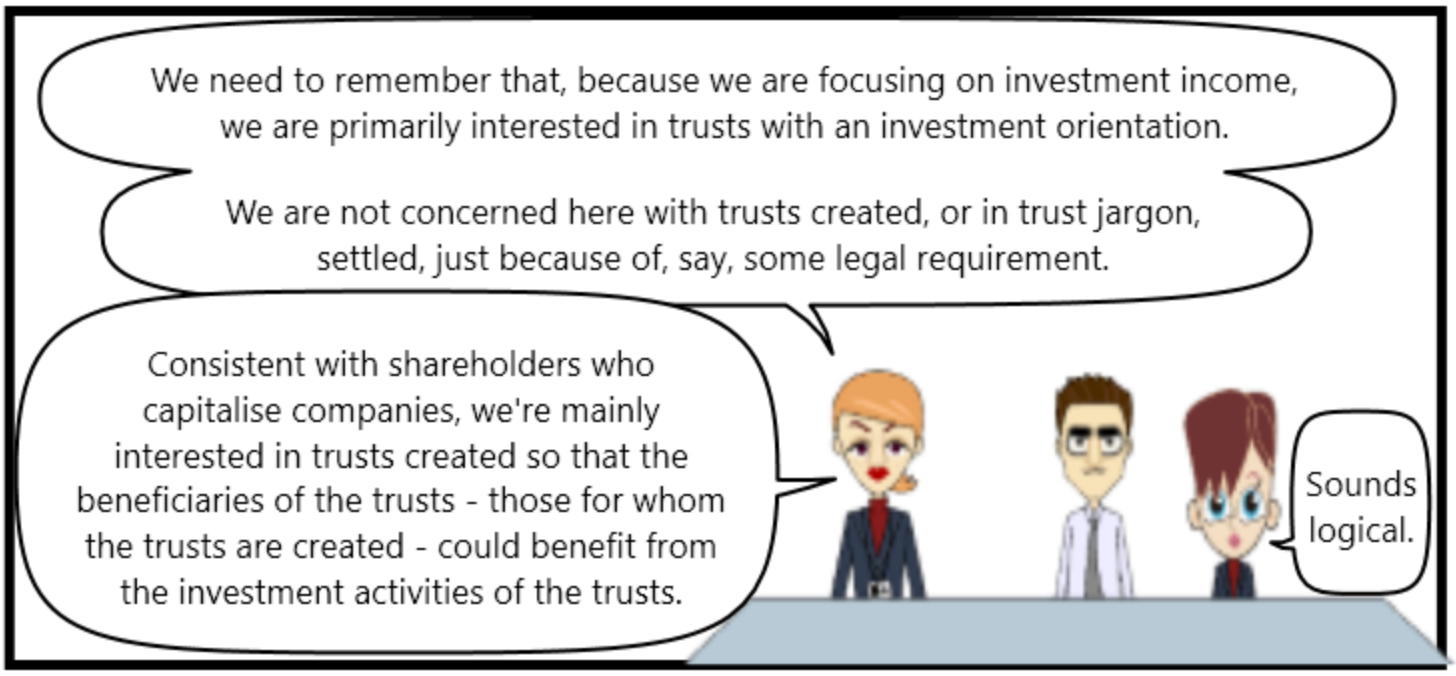
The team found background to current Australian treatment of foreign trusts in papers from a review by Australia's Board of Taxation, Board of Tax (2008).

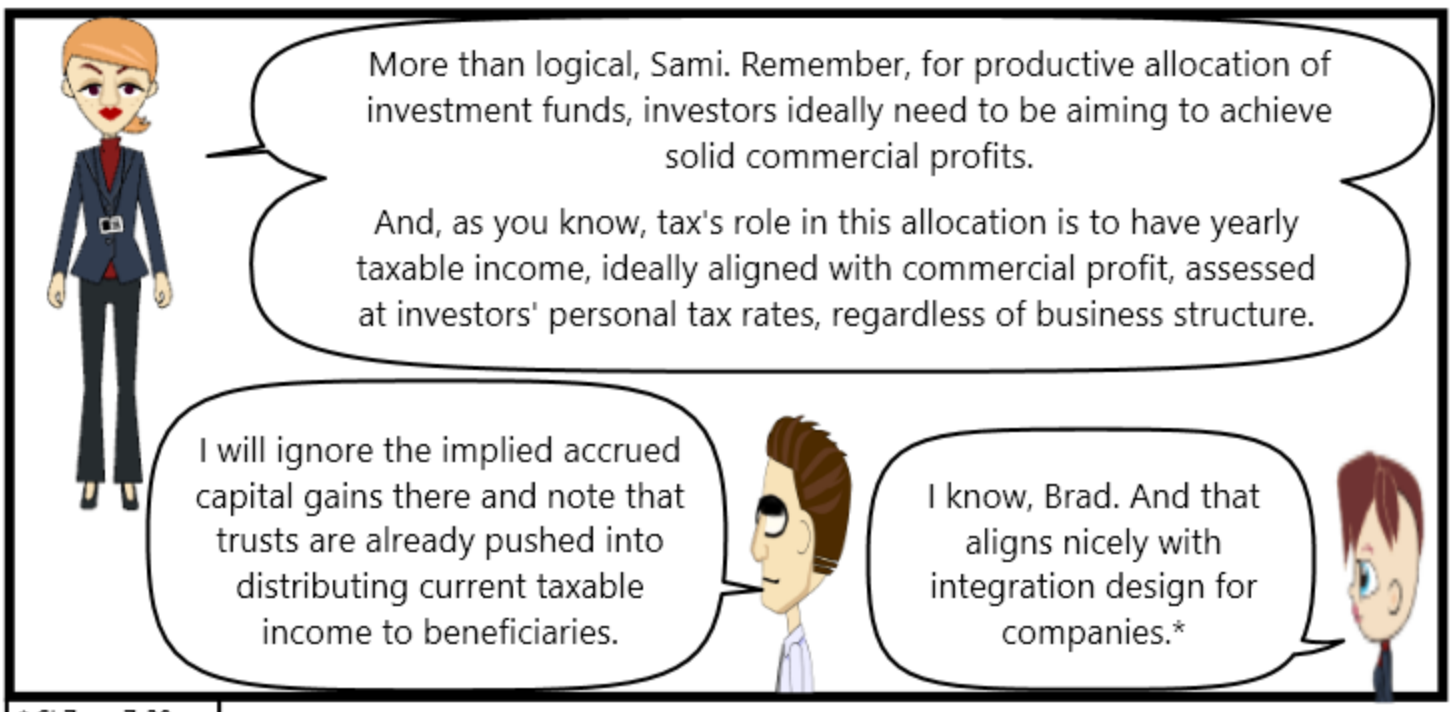
Helpful information on trusts, co-operatives and life insurers was found in two volumes of the 1999 Review of Business Taxation in Australia: Ralph Platform, Chapters 22, 23, 32, 34 and 35, and Ralph Review, Sections 13, 14 and 20. ATO (2016) also helps the team's analysis of the tax treatment of distributions of co-operatives.

The team's discussions on life insurers were also helped greatly by comments and suggestions from Anthony Regan, former senior executive in the Tax Law Division of the Australian Treasury, whose work on life insurers in the Ralph Platform and Ralph Review helped achieve significant improvements in the tax treatment of life insurers' activities in Australia. Ownership of those team discussions, however, definitely remains with the team.

The team plans for the Tax Minister's briefing

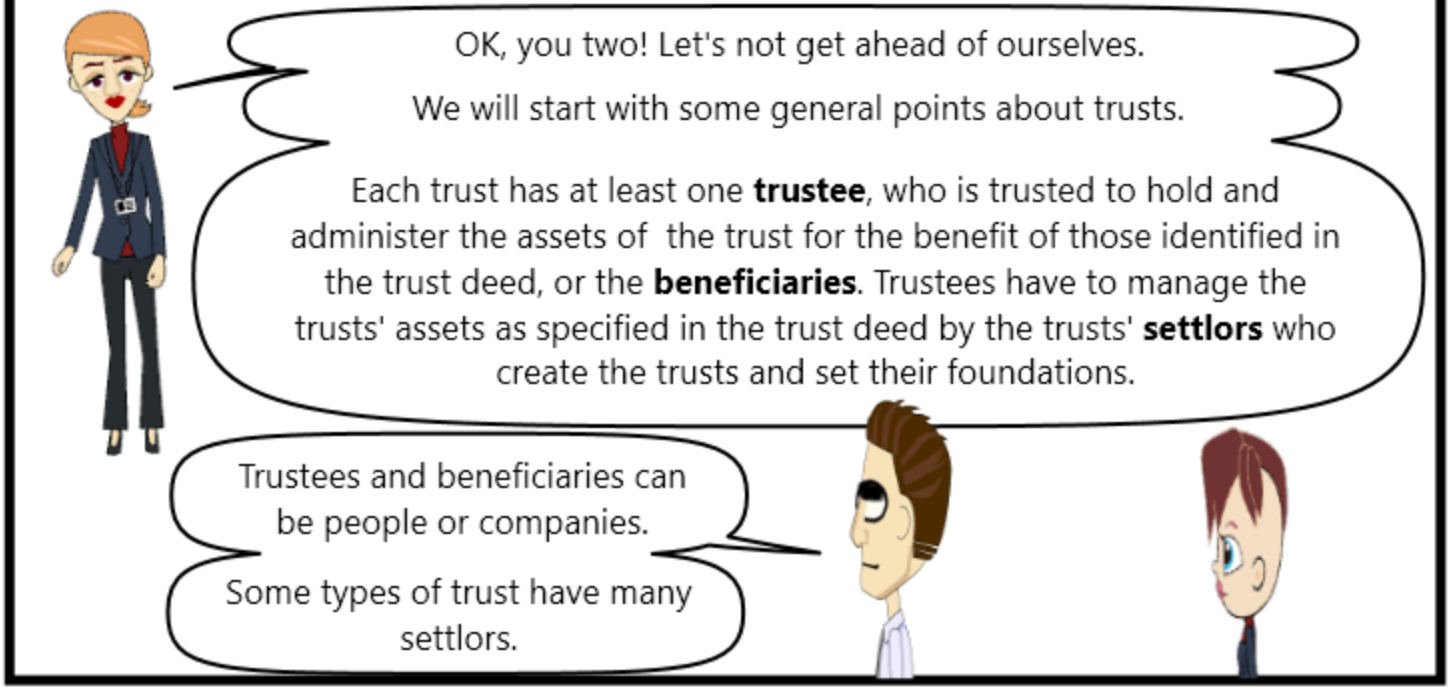


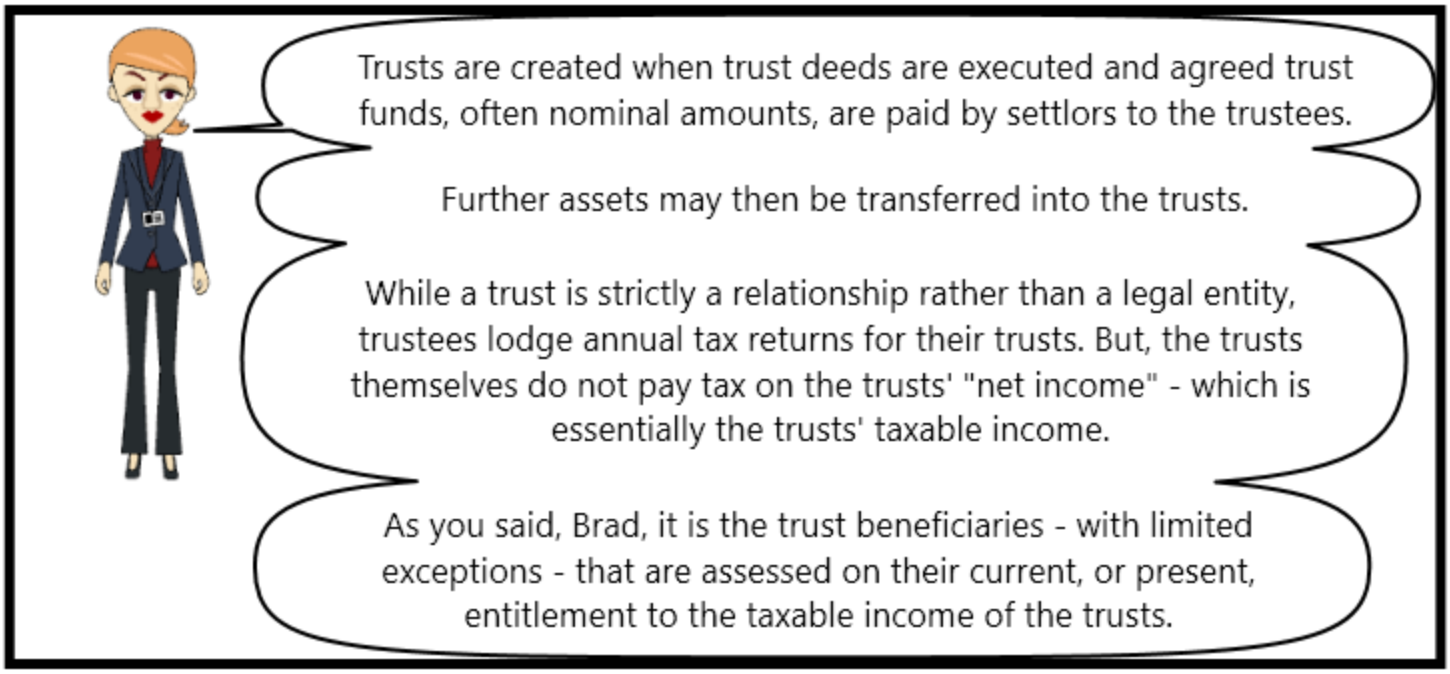


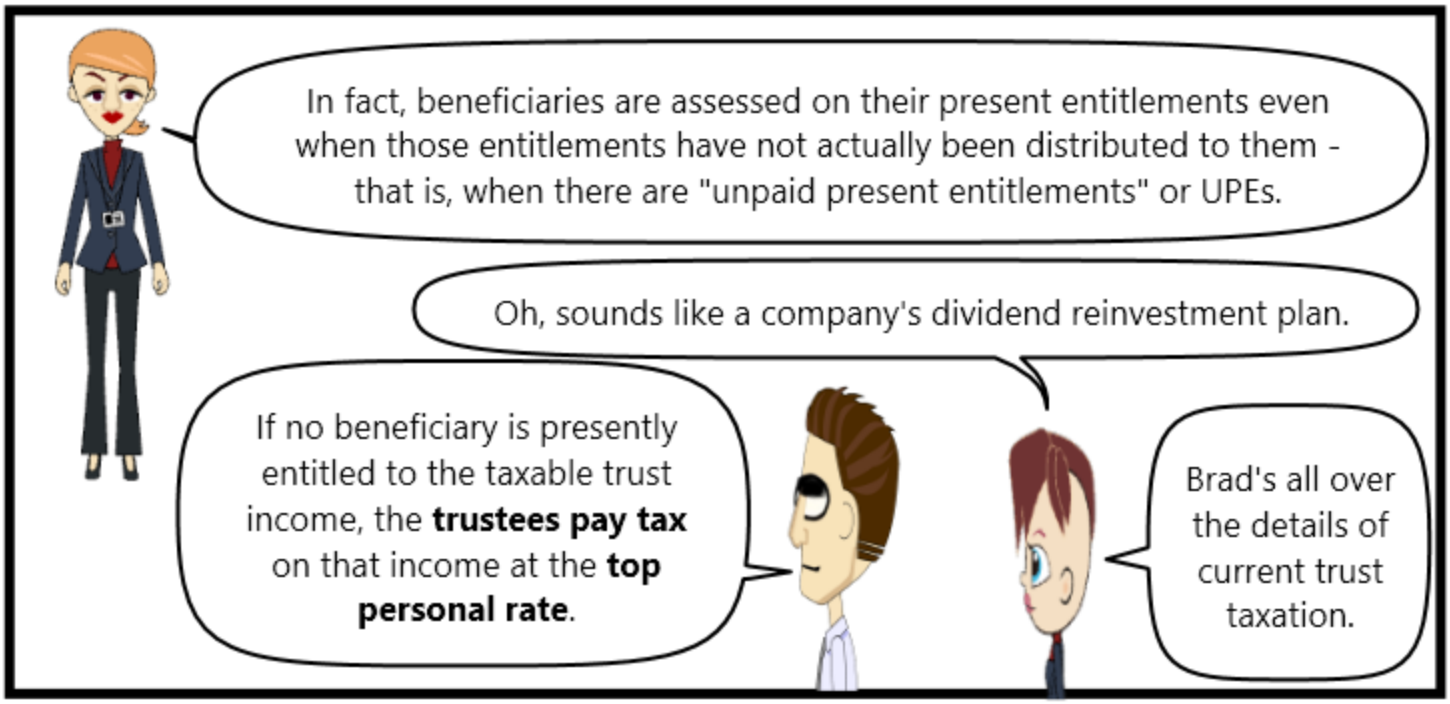


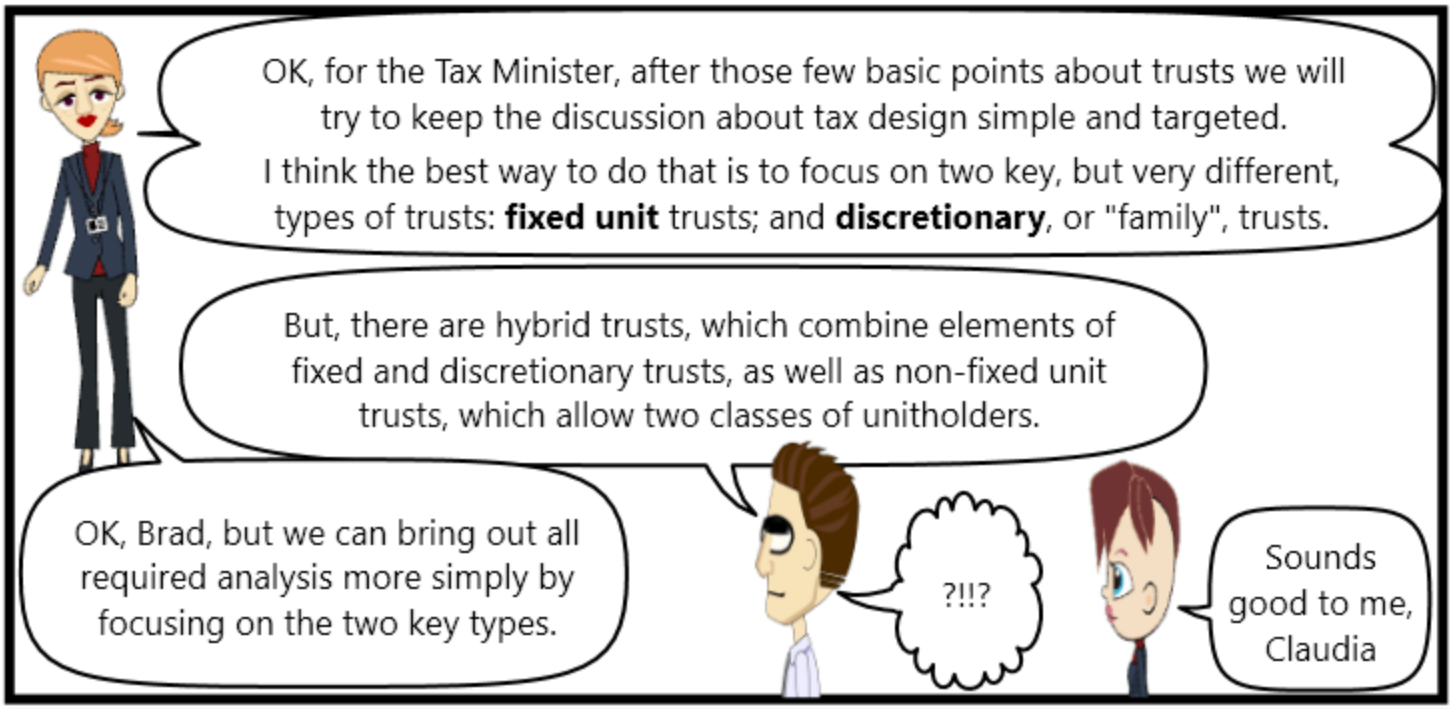
* Ch7, pp 7-30.

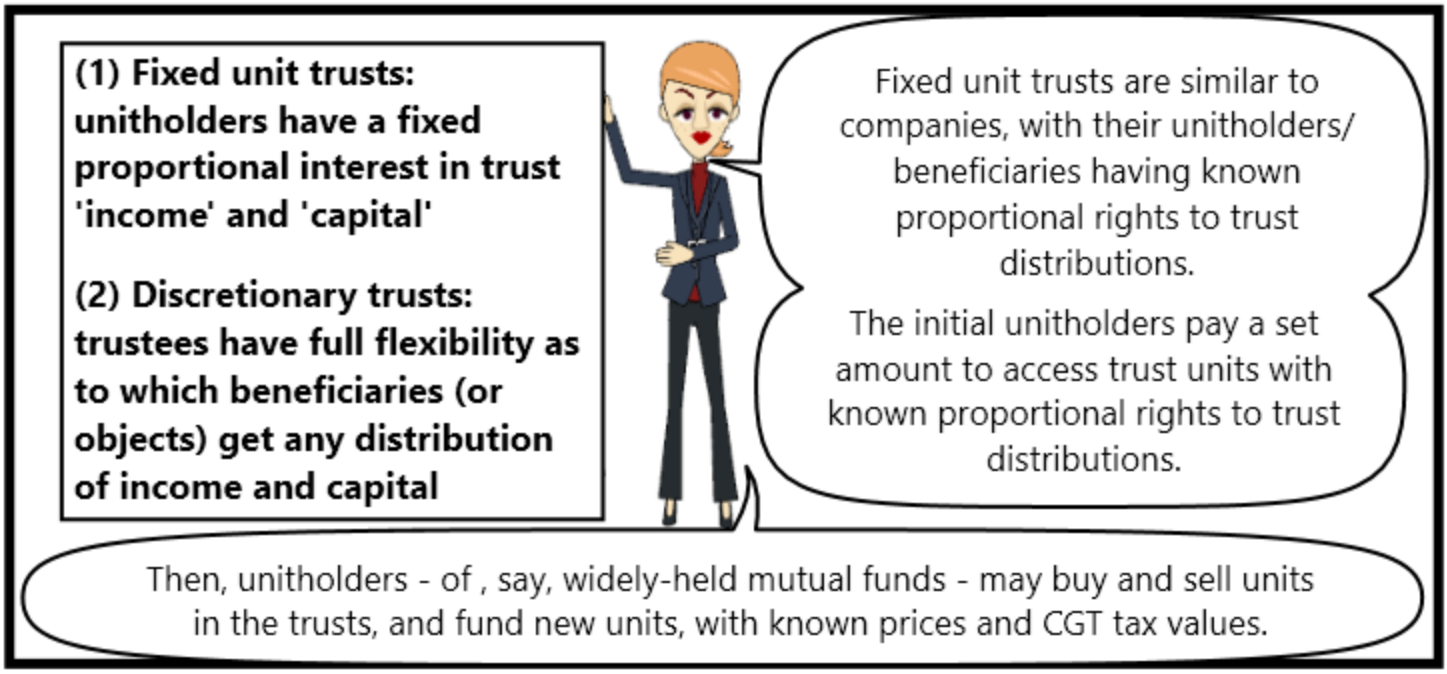
General background on trusts

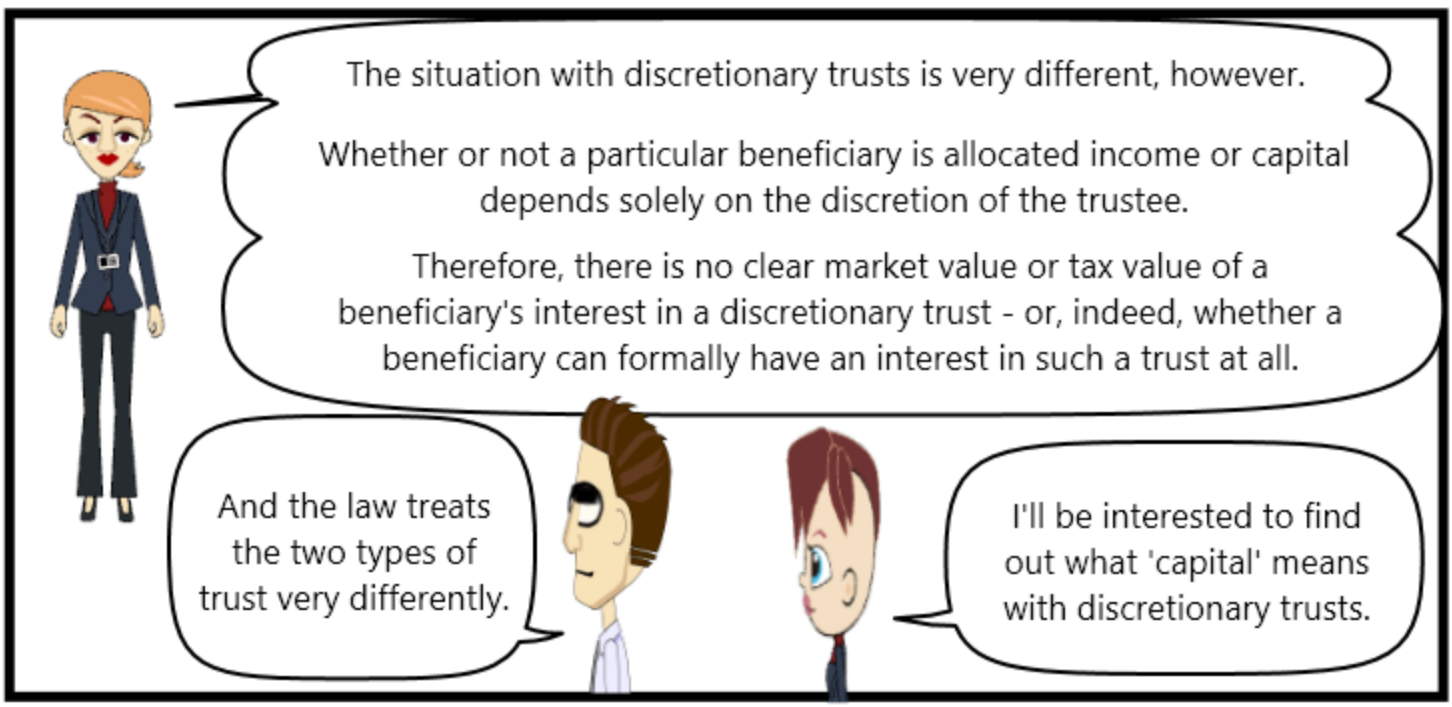


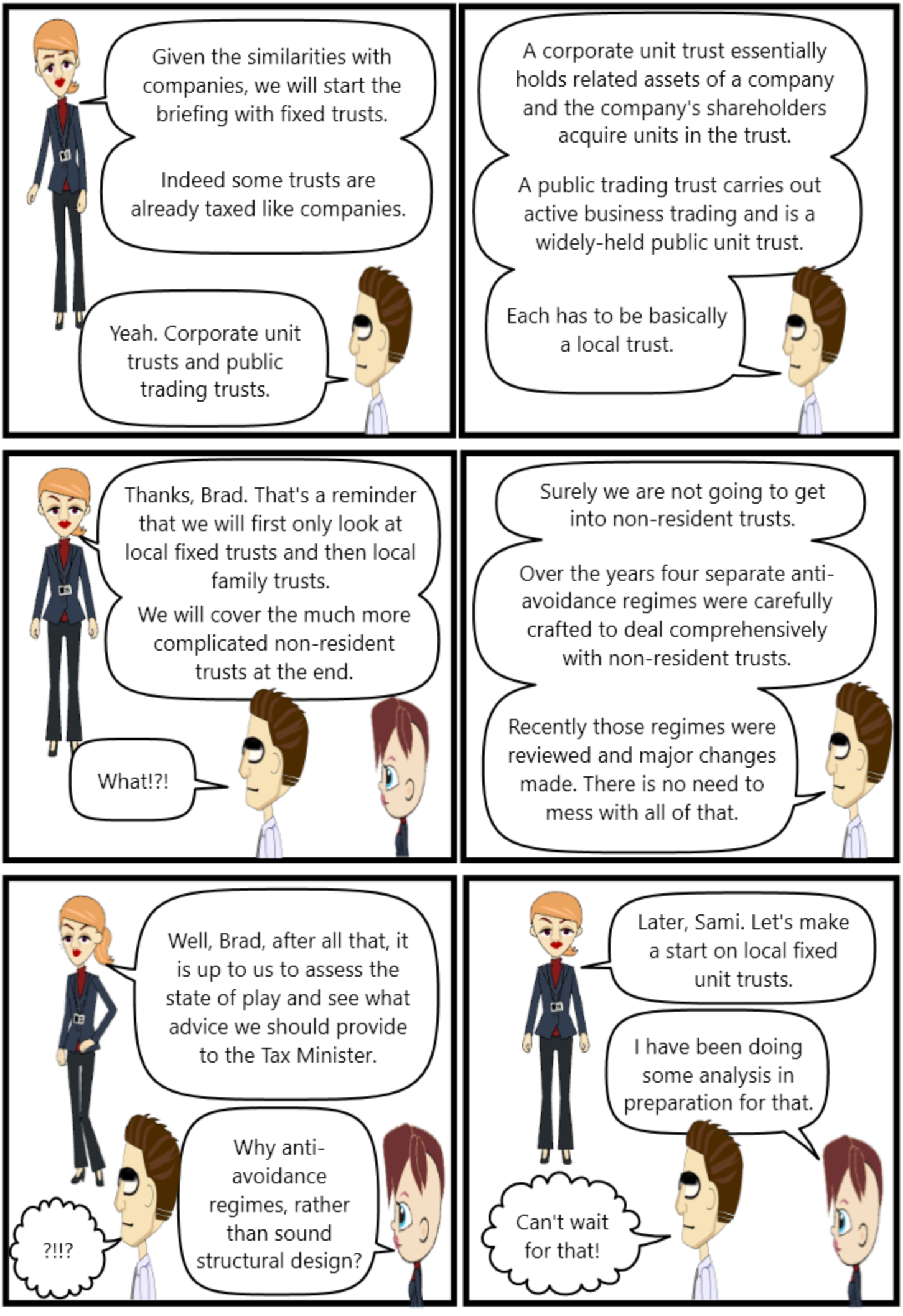




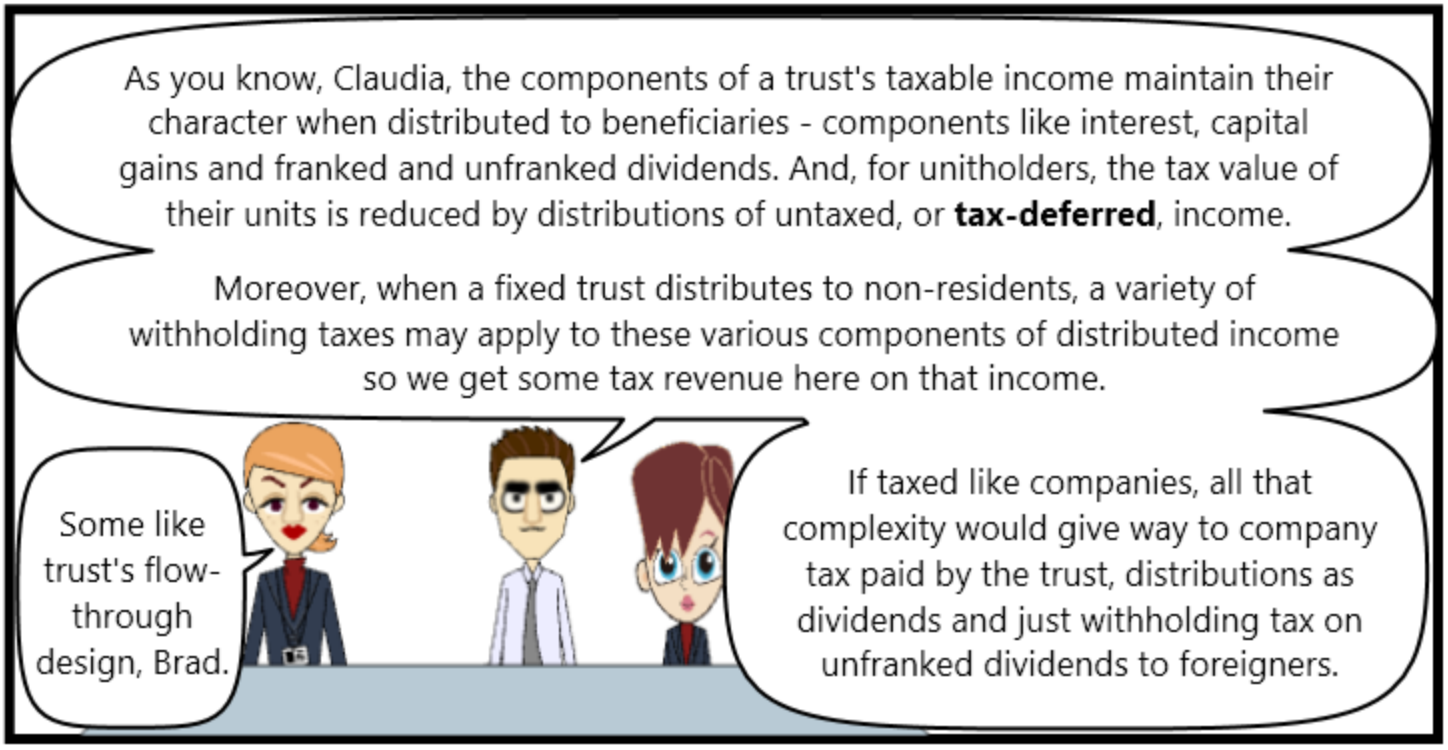

OK, for the Tax Minister, after those few basic points about trusts we will try to keep the discussion about tax design simple and targeted.
I think the best way to do that is to focus on two key, but very different, types of trusts: **fixed unit** trusts; and **discretionary**, or "family", trusts.
But, there are hybrid trusts, which combine elements of fixed and discretionary trusts, as well as non-fixed unit trusts, which allow two classes of unitholders.
OK, Brad, but we can bring out all required analysis more simply by focusing on the two key types.
?!!?
Sounds good to me, Claudia

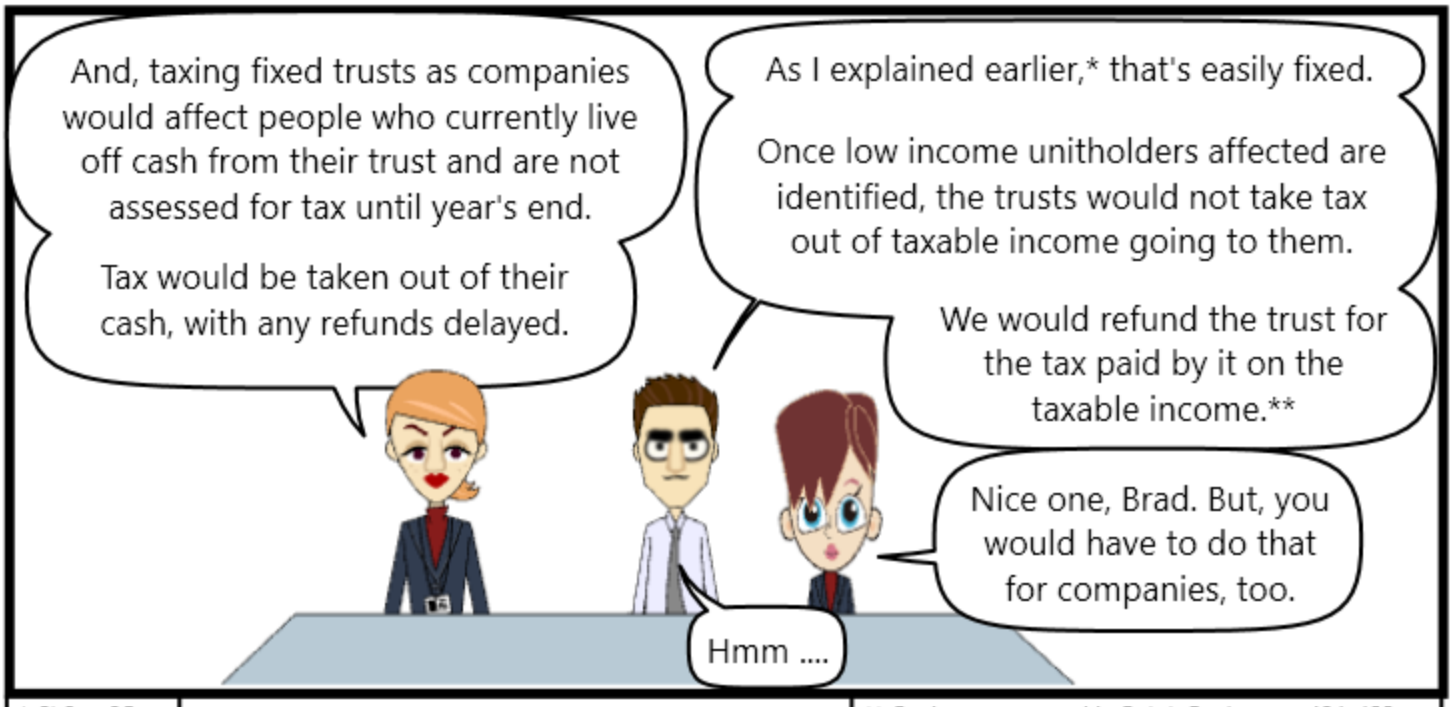

(1) Fixed unit trusts: unitholders have a fixed proportional interest in trust 'income' and 'capital'
(2) Discretionary trusts: trustees have full flexibility as to which beneficiaries (or objects) get any distribution of income and capital
Fixed unit trusts are similar to companies, with their unitholders/ beneficiaries having known proportional rights to trust distributions.
The initial unitholders pay a set amount to access trust units with known proportional rights to trust distributions.
Then, unitholders - of , say, widely-held mutual funds - may buy and sell units in the trusts, and fund new units, with known prices and CGT tax values.


The situation with discretionary trusts is very different, however.
Whether or not a particular beneficiary is allocated income or capital depends solely on the discretion of the trustee.
Therefore, there is no clear market value or tax value of a beneficiary's interest in a discretionary trust - or, indeed, whether a beneficiary can formally have an interest in such a trust at all.
And the law treats the two types of trust very differently.
I'll be interested to find out what 'capital' means with discretionary trusts.


Given the similarities with companies, we will start the briefing with fixed trusts.
Indeed some trusts are already taxed like companies.
Yeah. Corporate unit trusts and public trading trusts.
A corporate unit trust essentially holds related assets of a company and the company's shareholders acquire units in the trust.
A public trading trust carries out active business trading and is a widely-held public unit trust.
Each has to be basically a local trust.
Thanks, Brad. That's a reminder that we will first only look at local fixed trusts and then local family trusts.
We will cover the much more complicated non-resident trusts at the end.
What!?!
Surely we are not going to get into non-resident trusts.
Over the years four separate anti-avoidance regimes were carefully crafted to deal comprehensively with non-resident trusts.
Recently those regimes were reviewed and major changes made. There is no need to mess with all of that.
Well, Brad, after all that, it is up to us to assess the state of play and see what advice we should provide to the Tax Minister.
?!!?
Why anti-avoidance regimes, rather than sound structural design?
Later, Sami. Let's make a start on local fixed unit trusts.
I have been doing some analysis in preparation for that.
Can't wait for that!

Resident fixed unit trusts

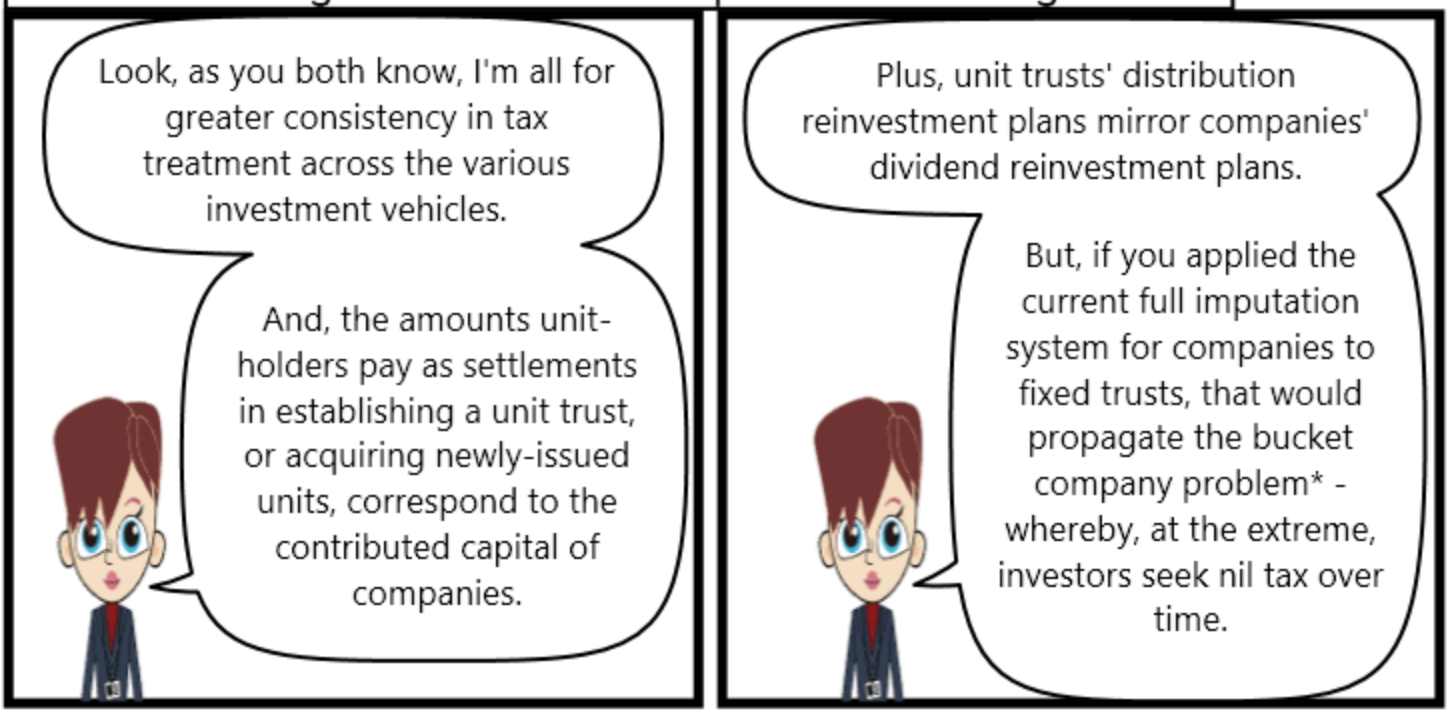


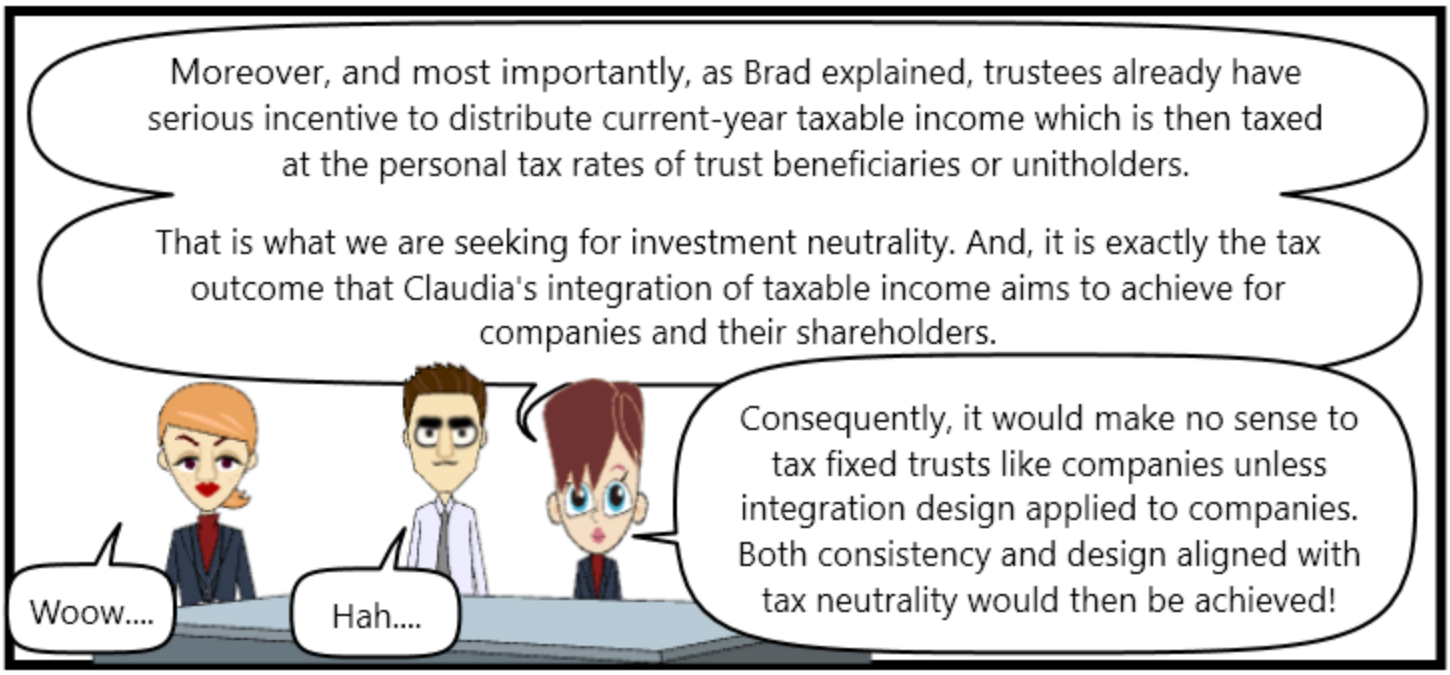


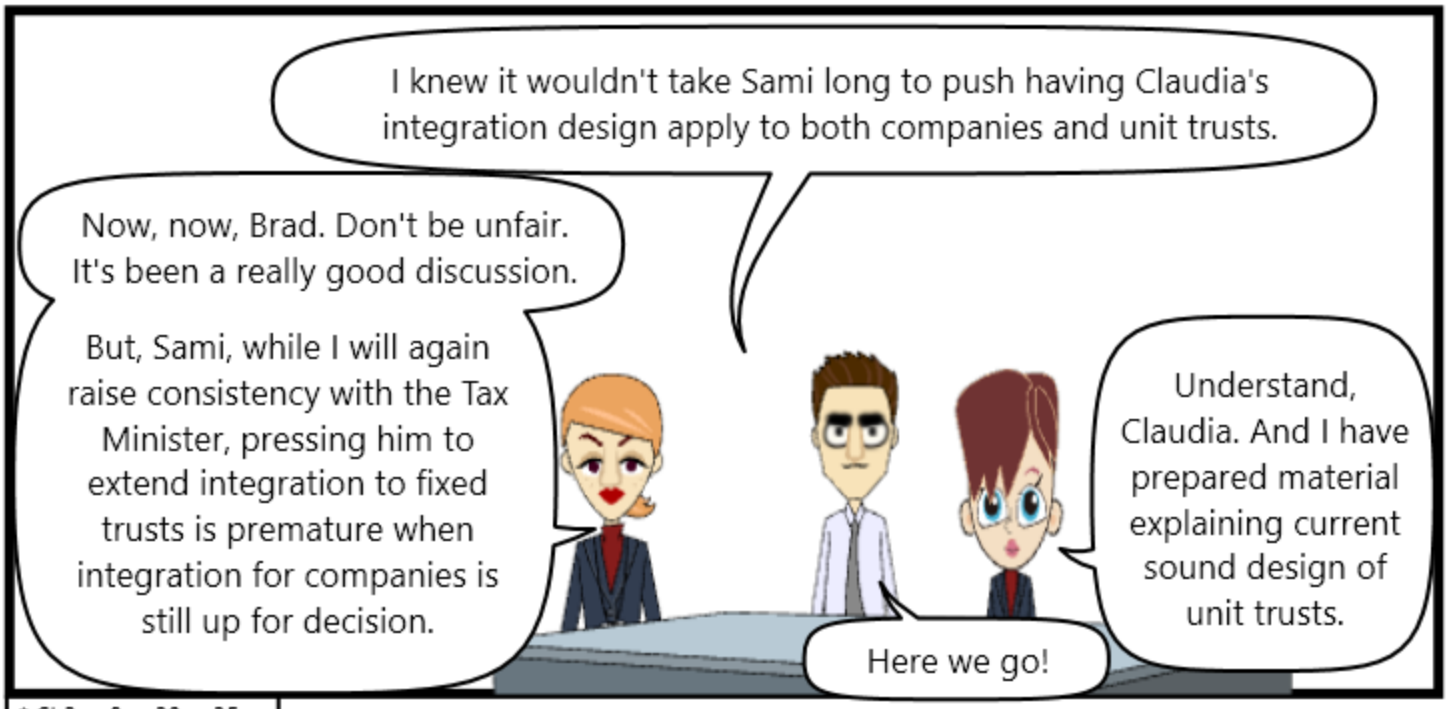
* Ch3, p 35.

** Options canvassed in Ralph Review, pp 421-423.

Sami likes taxing fixed trusts like companies under integration







* Ch3, p 8, p 20, p 35.

Comparison of tax treatment of fixed trusts and companies

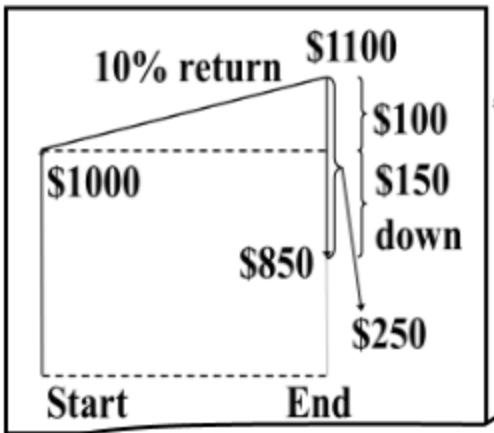
Claudia, I use your own charting to show how well current tax treatment of unit trusts dovetails with current company tax design - and, indeed, integration design.

Go for it, Sami.

Hmm ...

The chart I use is the one which shows a depreciating asset - a production machine - whose value declines by 15% pa. The asset is acquired for $1000 and produces a 10% pa return.

In its first year of ownership this 10% pre-tax return produces $100 of income which comes from $250 of cash as net receipts less $150 reduction in value of the asset to $850.



Here is the asset. Now, imagine a unit trust acquires the asset at the start of a year.

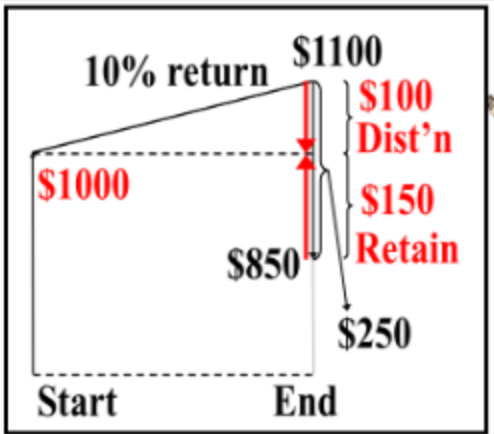
Immediately, you can see that we are dealing with two assets: the production machine; and, the units of the trust unitholders.

The value of the units will clearly be influenced by the value of the machine - but also by distributions from the trust.

Tax design has to deal with the two levels of assets involved here. I'm going to illustrate with **three outcomes**.

This'll be interesting

Thanks, Sami.



In the **first outcome**, the trust's taxable income matches the machine's $100 income because the machine's tax depreciation of 15% pa, or $150, matches its value decline.

Now, the value of trust units could increase to $1100 were all the $250 cash retained via distribution reinvestment.

But, here, the value of trust units remains at $1000, with the trust distributing only $100 cash, matching annual taxable income. The trust retains the other $150 of cash for additional investment.

Yeah.

OK. Good, Sami.

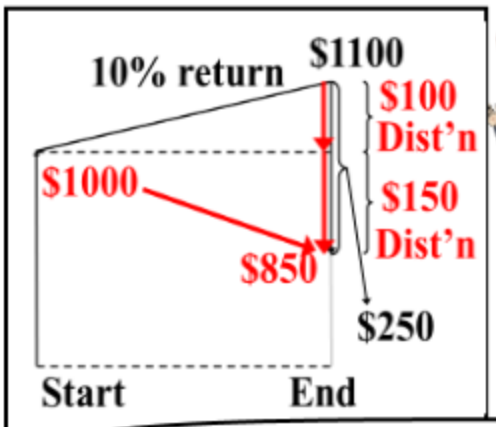
Now, we know that, as under integration, the CGT tax value, or cost base, of interests in unit trusts is reduced for trust distributions not in taxable income.

That leads to the next two outcomes, each where the trust not only distributes $100 of taxable income but also the other $150 of the $250 annual cash earned from the depreciating machine.

Each of these outcomes has parallels with company taxation, and each helps to maintain pre-tax pricing of trust units.

No doubt impractical conclusions coming.

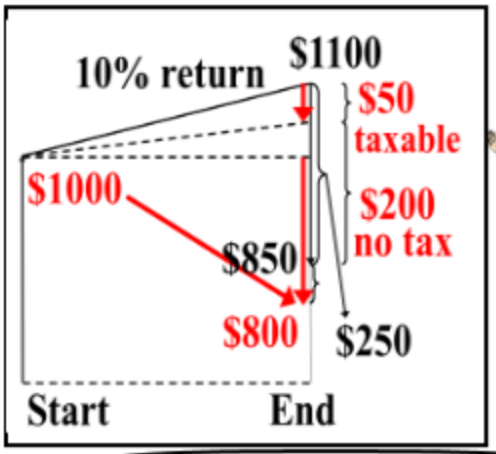
I like the lead-in, Sami.



In this **second outcome**, $150 of the distribution is untaxed because $150 tax depreciation again matches actual value decline of the machine. Thus, the units' CGT cost base would be reduced from $1000 to $850 in line with the units' value decline.

That ensures no double deductions as CGT losses if the units are sold for $850 - consistent with CGT cost base reductions for returns of capital with companies under imputation or integration.

Yep. Return of some of the $1000.

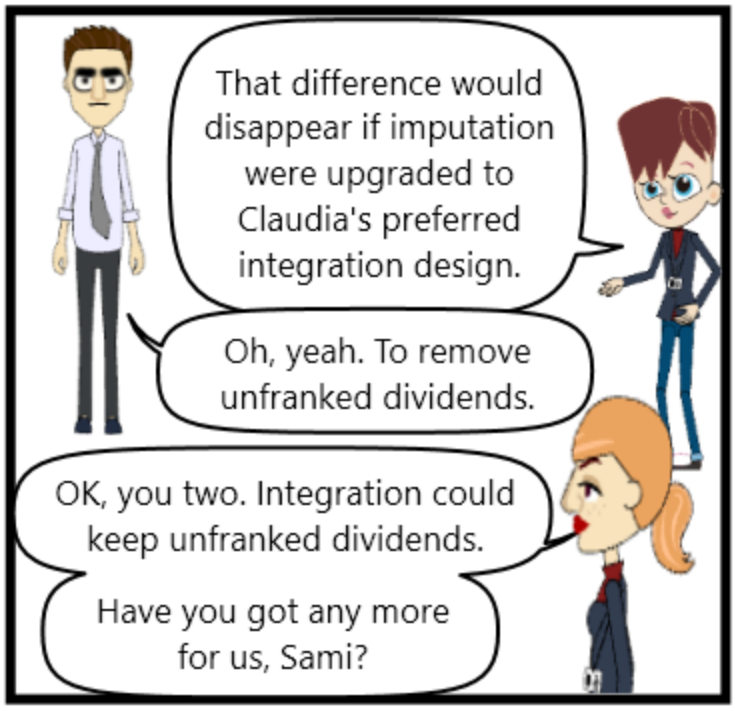


In the **third outcome**, only $50 of the $100 of machine income is included in taxable income because of tax breaks. The units' CGT cost base is reduced from $1000 to $800 by $200 of non-taxable distribution, $50 of which is tax-deferred income.

Nevertheless, that $50 of untaxed income would be taxed if the units were sold for $850.

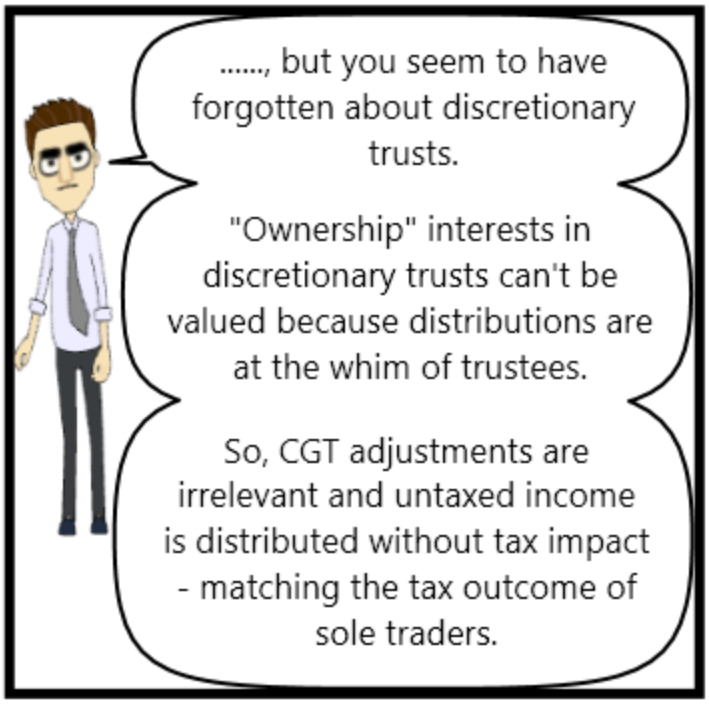
That outcome is consistent with what I think is Claudia's preferred integration design but not completely with current imputation design.

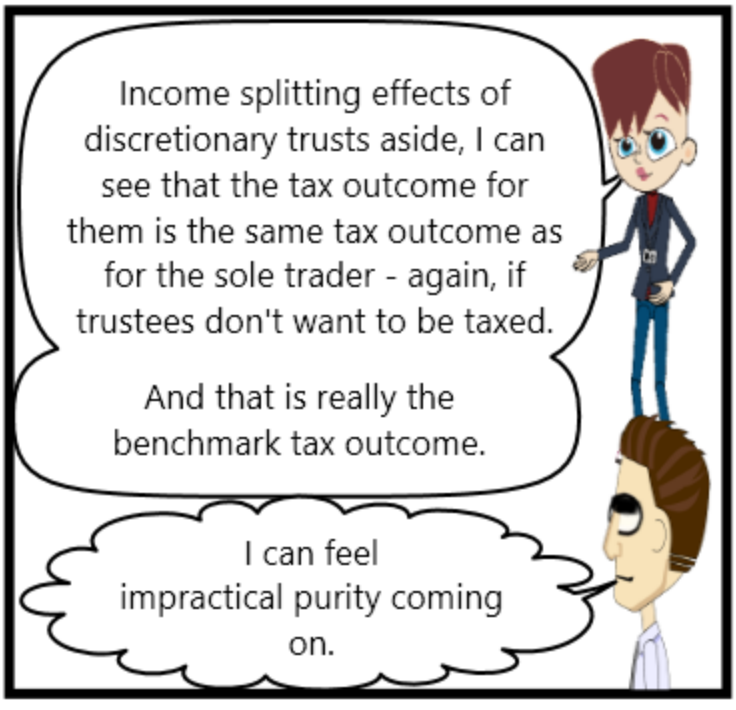
Yes! Under imputation: $50 franked; $150 capital return with cost base reduction; and $50 unfranked dividends.



IMPUTATION	INTEGRATION	UNIT TRUSTS
Current-year taxable income		
PRS if distributed	PRS	PRS
Current-year untaxed income		
PRS if distributed	Delayed PRS if distributed	Delayed PRS if distributed

PRS = personal rate scale





DISCRETIONARY TRUST	SOLE TRADER
Current-year taxable income	
PRS	PRS
Current-year untaxed income	
No tax	No tax

PRS = personal rate scale

See how the tax treatment of discretionary trusts and sole traders can easily align.

But, if integration applied to companies and if **taxable income matched commercial profit**, the tax treatment in both slides coalesces at personal rates.

And there it is!

Nice work, Sami. Note, the flow-through of income types aligns for the trust and trader.

Great discussion, you two. I'll draw on your slides, Sami, to bring out greater consistency from upgrading imputation to integration.

I'll also broach design consistency via applying integration to both companies and fixed trusts, drawing on Brad's practical design to deal with associated cash flow effects for low income people.

Sometimes coming to work feels so good!

Good luck with all that!

And, of course, show the benefits of getting **tax values closer to actual values** or taxable income closer to commercial profit.

But, to be realistic, as I mentioned before, it would be a major leap for the Tax Minister to take on both upgrading imputation to integration, as well as spreading integration to unit trusts.

That is particularly so when unit trust tax design is already conceptually very close to integration design - flow-through of income characteristics and zero tax at the trust level, aside.

I like the realism, Claudia.

Now, let's get more into local discretionary trusts.

Wait. I've got more, Claudia.

Still more!!

Attribution managed investment trusts (AMIT)

You might remember, Claudia, when you were going through CGT adjustments under integration design, I noticed a parallel with our attribution tax regime for management investment trusts, MITs.*

I've now looked more deeply into that regime, designed to remove unnecessary complexity and costs with MITs.

Essentially, an MIT is a local, widely-held managed fund undertaking passive investing, as opposed to active business activities.

Yeah, not a public trading trust, taxed like a company.

Right, Brad. The mutual funds that people invest in either directly or via their superannuation fund are MITs.

To qualify as, and elect to be, an attribution MIT, or AMIT, all members must have clearly defined interests in the income and capital of the MIT.

Consequently, not surprisingly, an AMIT will be a fixed unit trust.

But, most importantly, unlike fixed trusts generally, AMITs members do not get their proportionate share of the fund's taxable income based on their present entitlement to a share of the fund's defined income.

Instead, the various categories of an AMIT's taxable income are directly attributed - or allocated, to use your integration parlance, Claudia - to trust members based on their clearly defined interests in the trust.

The character of income received by an AMIT continues to retain its character when attributed to members.

But it is possible to stream income of a particular character to specific members with defined interests in that type of income.

Inevitable distribution errors are also formally accommodated. And, with a standard mutual fund that becomes an AMIT, members' tax statements still cover a full spread of income categories, each showing cash distribution and taxable or attribution amount.

Yes, thanks, Brad. And, there are two exciting AMIT features that I want to explain.

Oh, here we go again!

* Ch3, p 13, p 34.

(1) ATTRIBUTION MITs

CASH DIST'N > TAXABLE INCOME*(EXCESS)

Reduce CGT tax value of units**

Same as fixed trusts and integration

CASH DIST'N < TAXABLE INCOME*(SHORTFALL)

Increase CGT tax value of units

Like integration design: no double tax on sale of units; trustees not taxed on retentions (like reinvestments/UPEs)

* plus CGT discount less credits

** capital return/ tax-deferred income

First, for each AMIT income category there may be a difference between the annual cash distribution and the corresponding amount of taxable, or attributable, income.

Any difference in aggregate across all categories between cash and taxable income is reflected in the CGT tax value, or cost base, of members' units.

You must be excited too, Claudia, because those AMIT CGT adjustments mirror those in your preferred integration design - though you prefer no CGT discount.

(2) ATTRIBUTION MITs

MULTIPLE CLASSES OF UNITS

Allows each class to be treated as if it were a separate trust

Allows segregation of assets, with associated income attributed only to AMIT members with relevant interests

Might help with integration design

Second, and this is most exciting. Because members' defined interests are linked to AMIT income categories, AMIT design deals well with multiple classes of fund units.

This AMIT design could be a model for multiple share classes under integration - perhaps the most tricky feature of your integration design, Claudia.

Me thinks Sami wants fixed trusts taxed as companies under integration design.

Great work, Sami. In fact, the integration design team looking at integration has already realised the link between AMIT and integration design.

That is not surprising given AMIT was instigated by our tax administration people and the integrated design process brings policy, legislation and administration minds together.

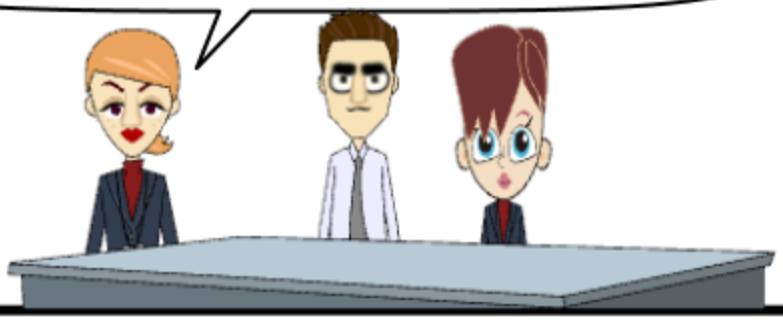
Note that often it will only be the shortfall AMIT tax value adjustment that distinguishes an AMIT annual tax statement from that of a regular mutual fund, or MIT.

OK. Thanks both of you. Now, we really need to get onto local discretionary trusts.

Resident discretionary (family) trusts

Remember, settlors create family trusts, and identify trustees who legally own trust assets and administer the trusts in the best interests of all trust beneficiaries.

Trust beneficiaries, or objects, may be specifically named in the trust deed or defined by their relationship to named beneficiaries - say, children and spouses and companies in which the named beneficiaries have shares.



The settlor is usually an experienced lawyer or accountant who drafts the trust deed and starts the trust by passing a nominal agreed amount to the trustee.

The settlor usually has no further involvement in the trust.

Yeah, settlors would face tax consequences if they benefitted from the trusts.

This avoids conflicts of interest in setting up the trusts, too.

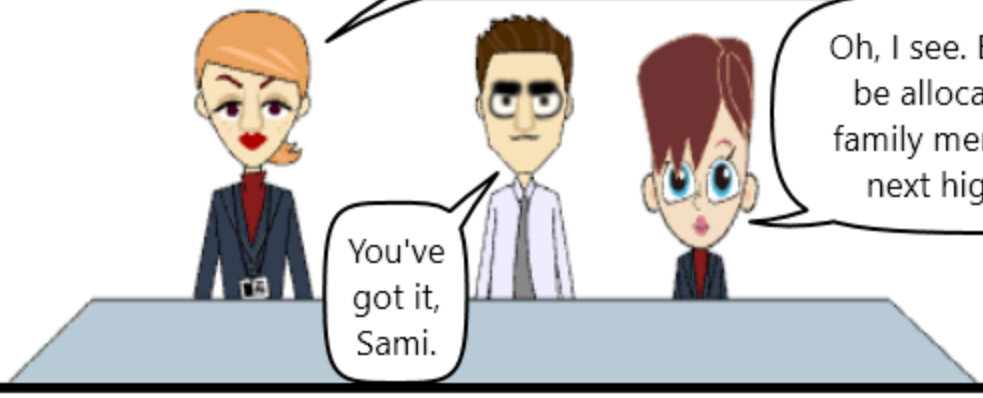
Once a trust is created, family assets are added.

Family trusts usually have the family's parents as the trustees - or the trustees are companies which have the parents as shareholders and directors.

Each year, the trustees decide if any entitlement to current trust income is to be given to each beneficiary separately and, if so, how much. Any entitlements will, no doubt, depend on the levels of other annual income of beneficiaries.

Oh, I see. Entitlements could be allocated, say, to keep family members below their next higher tax bracket.

You've got it, Sami.



I have a chart here, which we have seen before, showing a company and family trust structure used to reduce family tax bills.

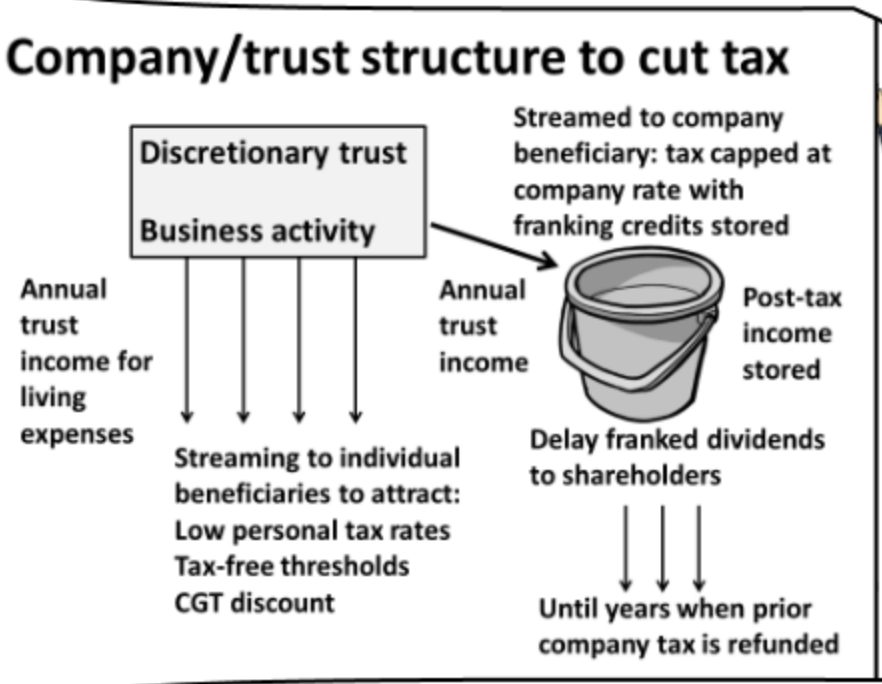
Of course, there are non-tax reasons for using family trusts, like asset protection and estate planning.

But I reckon more use should be made of our general anti-avoidance provisions because clearly tax minimisation is often a key objective.

Thank you, Brad.

Annual investment income earned in this trust is used for living expenses, with surplus stored, along with franking credits, in a "bucket" company owned by named beneficiaries.

As discussed before*, the company, taxed under our current imputation system, may hold back distributing until shareholders' low taxable income means they get a refund of prior company tax.



However, I want to emphasise that, the bucket company aspect is driven not by the tax treatment of family trusts, but by imputation's design.

But, the discretionary trust in the structure is chosen here because of the total discretion the trustee has to distribute any part of the income or property of the trust in any proportion to one or more beneficiaries - or to retain some income.

We will first look at this flexibility of the trustee. It is often the focus of possible changes to the taxing of trusts. Interestingly, changes could easily be made to reduce the tax revenue loss arising from the streaming of trust income to related beneficiaries - if the desire to do so were strong enough.

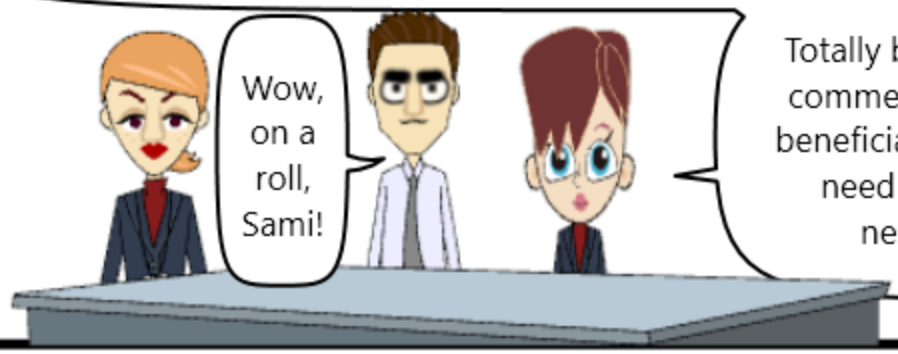
* Ch3, p 8.

Could I jump in, Claudia, to say unitholders in fixed trusts know their tax rates that will apply to their proportionate distributions of annual taxable income.

Consequently, they can take commercial decisions whether or not to remain unitholders on the basis of their trust's investment strategy.

But, with family trusts, beneficiaries don't know if they are going to receive any annual trust income and, when they do receive it, it is often allocated on the basis of tax minimisation arranged by the trustee.

Moreover, the beneficiaries don't have a clear ownership interest in the trust. As Brad explains, there can't be any value put on contingent rights to trust income.



Totally broken here is any link to commercial decision-making by beneficiaries as investors, and the need for that to achieve tax neutrality of investing.

I told you trusts were a tax rort. Tax them like ....

Taxing family trusts like companies, Brad, would mean applying tax at the trust level, with tax credits going to beneficiaries if they got some taxable income.

Yes, so?

As Claudia pointed out the streaming of income to the bucket company in her slide is driven by imputation company tax design.

Moreover, for beneficiaries, there are no clear ownership interests to which associated tax values can apply.

As Brad said, Sami, there are legitimate non-tax reasons for family trusts. And tax should not smother those.

Sure, Claudia, but seems to me the strengthening of tax-neutral outcomes would be achieved if the trustees paid their own personal tax on trust income - or faced the top personal rate - and distributed post-tax income.

Response to family trust streaming

The tax code already applies a very low tax-free threshold to family trust income, as 'unearned' income, paid to beneficiaries who are minors - or, indeed, to income from mutual funds or shares for that matter. The very low threshold aims at discouraging adults diverting income to their children and getting it back.

Above that threshold, the highest marginal personal tax tax rate usually applies.

That might give you the tax-neutral approach you wanted, Sami.

Certainly would stop the splitting.

Right, Brad. So, a similar approach could be applied to, say, spouses and other family members who are beneficiaries.

Investment decisions and distributions might be made by trustees consistent with those of top rate taxpayers who then provide after-tax funds to their families.

But, Sami, our advice might lose credibility if I put that to the Tax Minister....

....and then explained how the family trust sector would react.

Realistically, it is best to give strength to existing arrangements.

For example, allow marginal tax rates to apply only to specified family member categories - with the top rate applying to others.

And, seek to ensure distributions of income to eligible family members are clearly for the benefit of those members.

Now, I want to work through further issues that are quite technical.

These issues involve the interaction of trust law and income tax law.

They include issues concerning: **unpaid present entitlements**, or UPEs; **contributed capital**, including new funds added to family trusts; and implications of **income definitions in trust deeds**.

Have to be careful messing with trust law!

I just want to briefly discuss each issue to help compile my presentation.

This is what I've been waiting for.

Unpaid present entitlements, UPEs

Let's start with unpaid present entitlements as a continuation of our discussion on entitlements of trust beneficiaries.

Specifically, I want to discuss UPEs of bucket companies that are beneficiaries of family trusts.

As we noted, shareholders of the companies are family members, like the family parents.

I'm planning on covering **two UPE matters** with the Tax Minister to highlight the issues involved.

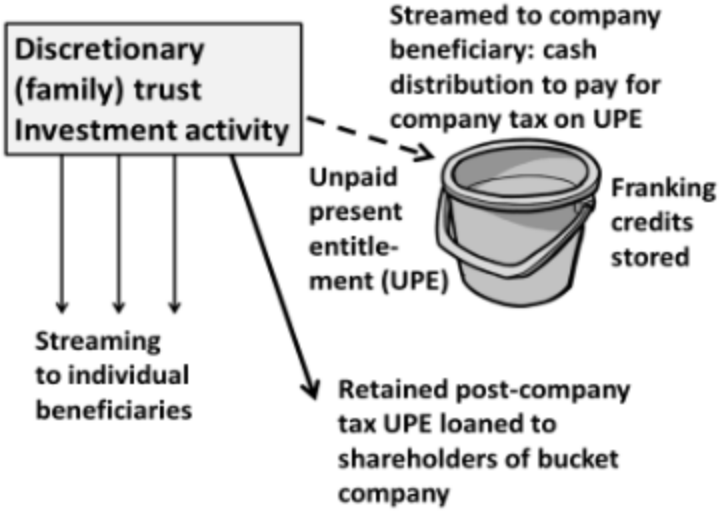
Bucket company UPEs!!

So exciting!

We saw how family trusts may stream annual entitlements to bucket companies. Taxable income in those entitlements is taxed at the company tax rate, say, 30%.

That 30% rate applies even when the entitlements are not paid out in cash and are retained as UPEs in the trust for further investment.

Company/trust structure to cut tax

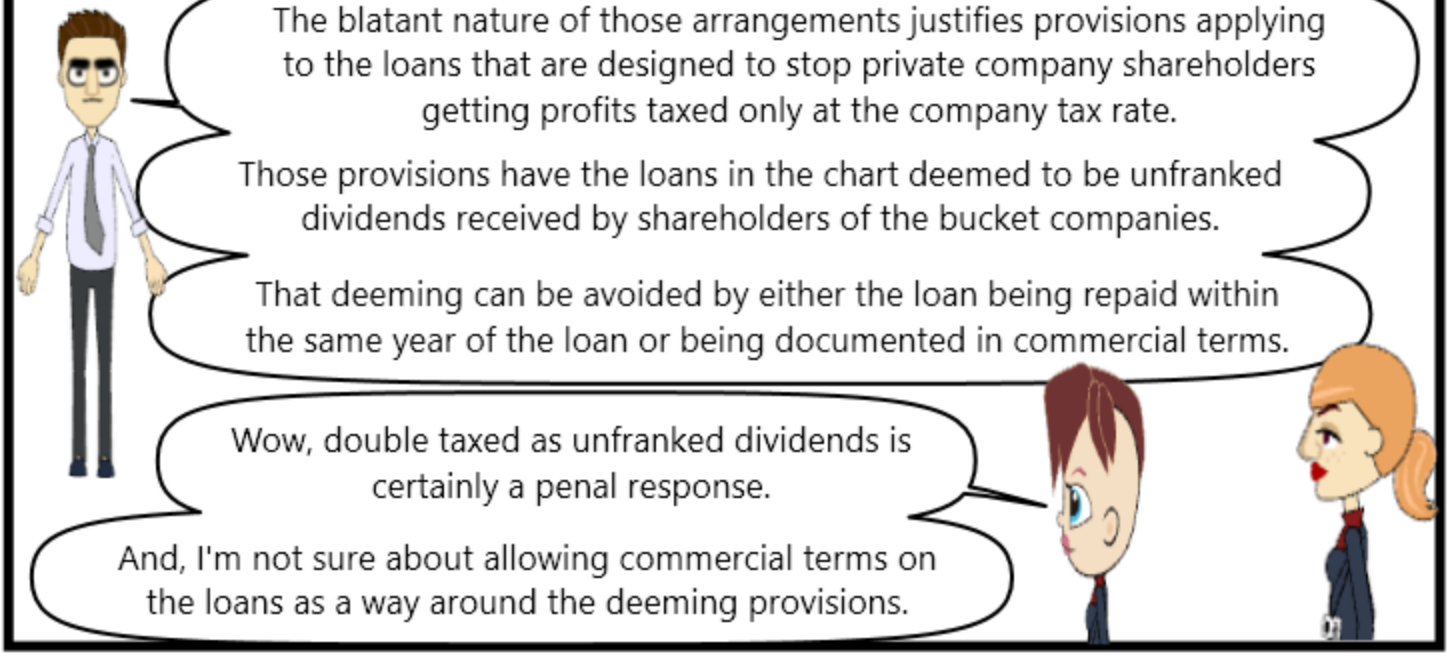


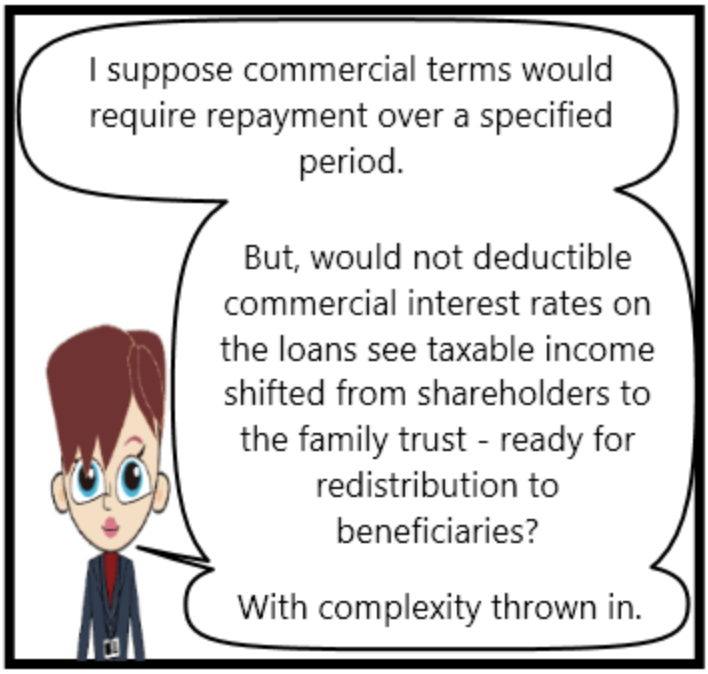
Typically, sufficient cash is streamed to the company for it to pay company tax. Associated franking credits are stored even though entitlements have not been paid in cash.

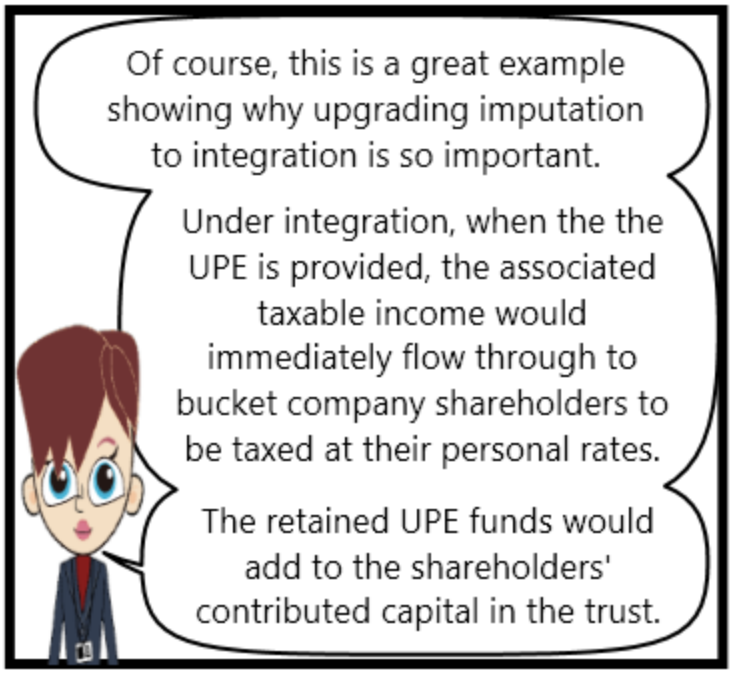
But, as this chart shows, the same retained post-tax UPE funds are then often loaned out to shareholders of the bucket company. This is my **first UPE matter**.

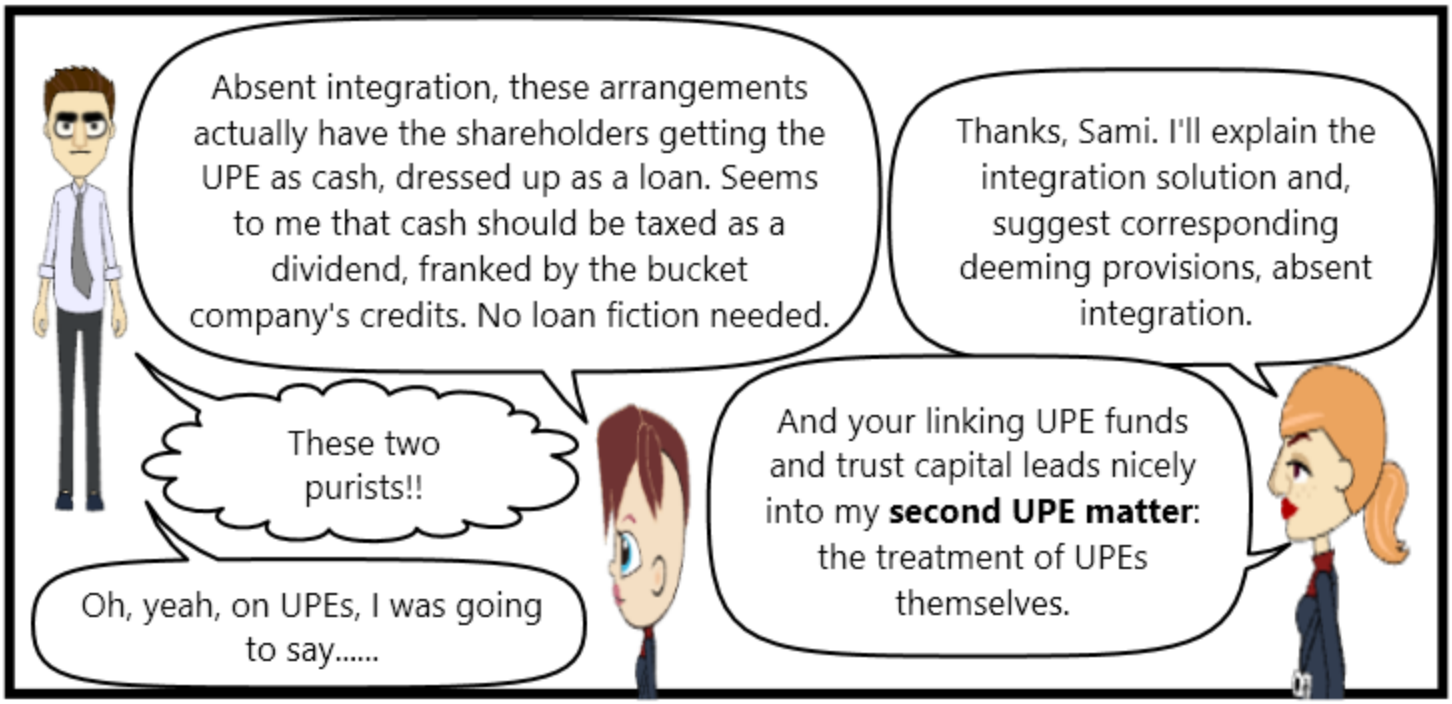
That is a blatant arrangement that allows family shareholders to access trust income while only paying a maximum of 30% on that income.

The UPE looks like a reinvestment arrangement to me. But I think I agree with Brad on how to view the loan.

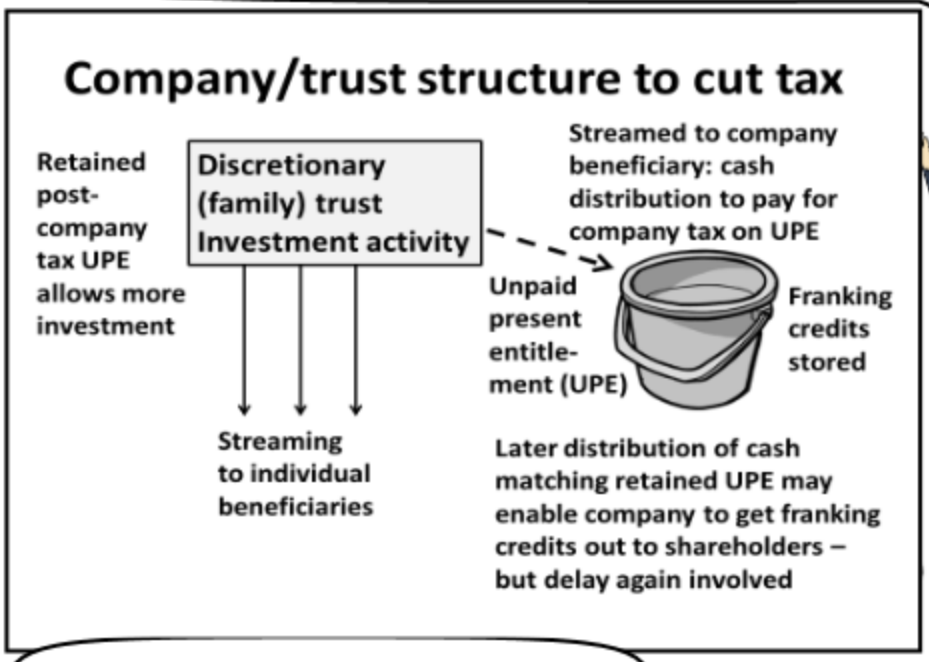

The blatant nature of those arrangements justifies provisions applying to the loans that are designed to stop private company shareholders getting profits taxed only at the company tax rate.
Those provisions have the loans in the chart deemed to be unfranked dividends received by shareholders of the bucket companies.
That deeming can be avoided by either the loan being repaid within the same year of the loan or being documented in commercial terms.
Wow, double taxed as unfranked dividends is certainly a penal response.
And, I'm not sure about allowing commercial terms on the loans as a way around the deeming provisions.


I suppose commercial terms would require repayment over a specified period.
But, would not deductible commercial interest rates on the loans see taxable income shifted from shareholders to the family trust - ready for redistribution to beneficiaries?
With complexity thrown in.


Of course, this is a great example showing why upgrading imputation to integration is so important.
Under integration, when the the UPE is provided, the associated taxable income would immediately flow through to bucket company shareholders to be taxed at their personal rates.
The retained UPE funds would add to the shareholders' contributed capital in the trust.


Absent integration, these arrangements actually have the shareholders getting the UPE as cash, dressed up as a loan. Seems to me that cash should be taxed as a dividend, franked by the bucket company's credits. No loan fiction needed.
Thanks, Sami. I'll explain the integration solution and, suggest corresponding deeming provisions, absent integration.
These two purists!!
And your linking UPE funds and trust capital leads nicely into my **second UPE matter**: the treatment of UPEs themselves.
Oh, yeah, on UPEs, I was going to say.....

This chart simply illustrates a bucket company paying 30% company tax on UPEs from a family trust that are retained in the trust for further investment.



Claims that UPEs are anti-avoidance devices are avoided if the retained funds become capital of a new sub-trust to the exclusive benefit of the company. That stops streaming of the UPE to other beneficiaries.

This is what I wanted to say before.

The UPE with associated funds retained, is obviously equivalent to a loan being made by the company back to the trust.

Again, those private company deeming provisions should tax the UPEs at the top personal rate as unfranked dividends paid back to the trust, unless the loan is on commercial terms.

Oh, c'mon, Brad, there are so many things wrong with that!

Where do I start? The trust is not a shareholder of the company.

My head is spinning from the company paying tax on the UPE **plus** dividend deeming of the UPE applying either to the trust or, if the UPE funds are "on-lent", to the company's shareholders.

If the entitlement were paid in cash to the company, only 30% would be paid on it initially - with imputation design seeing shareholders not paying tax on it at their rates until it is distributed.

You can't solve dividend lags under imputation by a ham-fisted second-best solution.

In any case, for me, a UPE is like a distribution reinvestment arrangement, with extra funds settled on the trust or sub-trust.

We are not a uni, you know.

OK, you two. That's helpful discussion and a good segue into trust capital.

Contributed capital, or corpus, of discretionary trusts

It is clear what contributed capital is with companies and fixed unit trusts. It is the funds contributed by, or on behalf of, a class of shareholder or unitholder to be used to earn future profits.

A similar, clear, commercially-sound measure of contributed capital should apply with the discretionary trusts that we are interested in.

Logically, that would include initial amounts settled on such trusts - the so-called 'corpus' - plus any later additional settlements.

New settlements would have to go into a new trust if the interests of existing beneficiaries changes or new beneficiaries included.

I totally agree with both of you. What I have been saying is that UPEs are just additional settlements of contributed capital for the benefit of beneficiaries.

Just like reinvestment plans see shareholders and unitholders receive extra shares and units for their capital reinvested.

Under trust law, I don't think the legal status of UPEs is totally clear.

Thanks, Brad. But we just need to be clear of their treatment under tax law. And, I agree totally with Sami's assessment of UPEs as new settlements.

Also, I believe undistributed trust income that has been taxed to the trustee or to beneficiaries could be added to the trust's corpus.

Yes, the trusts may accumulate such income as part of their corpus and the deed usually gives the trustee power to distribute that corpus - without being taxed again, of course.

Sounds like it is easier to get capital out of these trusts than for companies.

And how are beneficiaries taxed outside a UPE without getting the income?

I'll cover that later, Sami.

Capital gains and discretionary trusts

Y'know, under trust law, capital gains are not part of trust income; that is, income that can be distributed to beneficiaries - or, **distributable trust income**.

However, if the trust deed gives the trustee the power, capital gains can be included in the trust's distributable income.

Overriding all that, our tax law makes clear that through the tax deed and resolutions, any beneficiary can be made **specifically entitled** for tax purposes to any or all of the trust's capital gains - **whether or not** the gains are part of the trust's distributable income.*

So, very broadly, beneficiaries work out their shares of the trust's taxable income from capital gains, after any lesser capital losses and discount, based on their shares of any gross gains to which they **are**, and to which they **are not**, **specifically entitled**.

Gross trust gains **not** specifically allocated are spread across beneficiaries in line with the proportion of **distributable trust income** each beneficiaries is entitled to.

Beneficiaries then take into account in their own assessments discounted gains in their share of the trust's taxable income from capital gains.

If there is some distributable income to which no beneficiary is entitled, the trustee should be taxed on the corresponding proportion of the trust's taxable income from capital gains not specifically allocated.

Wow! Complicated.

Sami, you ain't seen half of it.*

Gosh, if gains are not in distributable income, beneficiaries will be taxed on any gains not specifically streamed even though they don't actually receive that income. Distributable income should match taxable income, including from gains.

Then, the proportions of distributable income streamed by a trustee to beneficiaries would match their liability to tax on that income.**

OK. Let's hold it right there. I'll take it from here into my **final topic on local family trusts**: tax implications of income definitions in trust deeds.

* See analysis of tax design in Walpola (2020), pp 333-345.

* ATO (2021).

** Walpola (2020), p 348.

Tax implications of income definitions in trust deeds

There have been many court decisions over recent years concerning discretionary trust income and, in particular, two different definitions of income.

First, there is trust income able to be distributed, as defined in trust deeds and potentially varied from time to time by trustees with the power to do so. This measure, as noted by Brad, is often logically termed **distributable income***.

In the absence of a definition of distributable income in the deed or by the trustee, the **default** definition is **ordinary income from trust law**.

Excludes capital gains and credits.

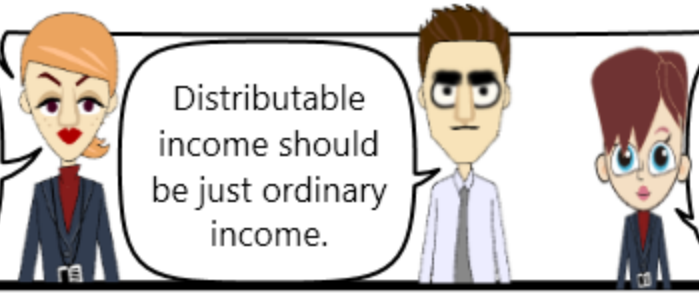
Remind me what ordinary income is.

Secondly, there is the definition of trust income, or **net income,** in our **tax law**.

Net income is basically the trust's annual **taxable income**.

There is no legal requirement for a trust's distributable income to match its taxable income. In fact, courts have ruled that trust deeds and related trustees' powers determine distributable income - with beneficiaries taxed on trust taxable income on a **proportionate basis**; that is, in line with the spread of available distributable income across beneficiaries.**

I'll explain with a trust that has **ordinary income** and **capital gains**.



Distributable income should be just ordinary income.

I don't understand. Trustees are taxed on taxable income that is not distributed.

(1) Set against annual trust taxable income and necessary powers in the deed, the trustee decides (a) distributable income, including whether or not it includes taxable capital gains (b) the %ages of distributable income to be streamed to beneficiaries (c) the %ages of capital gains to be specifically streamed to particular beneficiaries.

(2) Overall, each beneficiary is assessed on: any specific % age allocation of capital gains; *plus* other trust taxable income not in distributable income - including capital gains not specifically allocated - on a proportonate basis; *plus* any %age entitlement to remaining distributable income.

(3) The trustee should be taxed on any trust taxable income not taxed to beneficiaries.

See how tax current design combines Brad's explanation of CGT treatment with the court's proportionate approach.

* Treasury (2011), p 3.

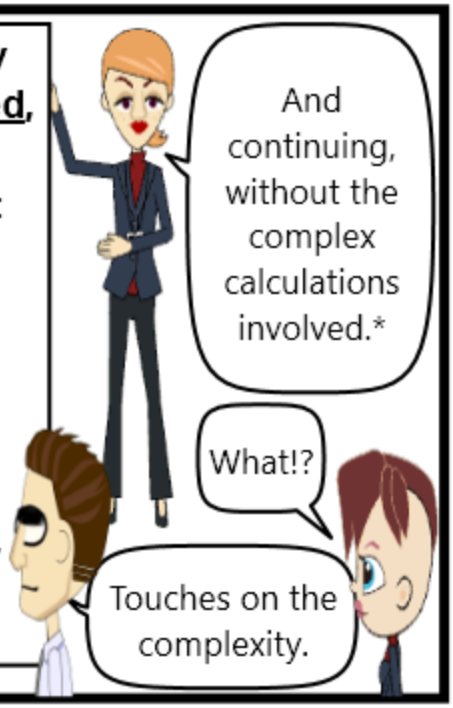
** Walpola (2020), pp 319-320.

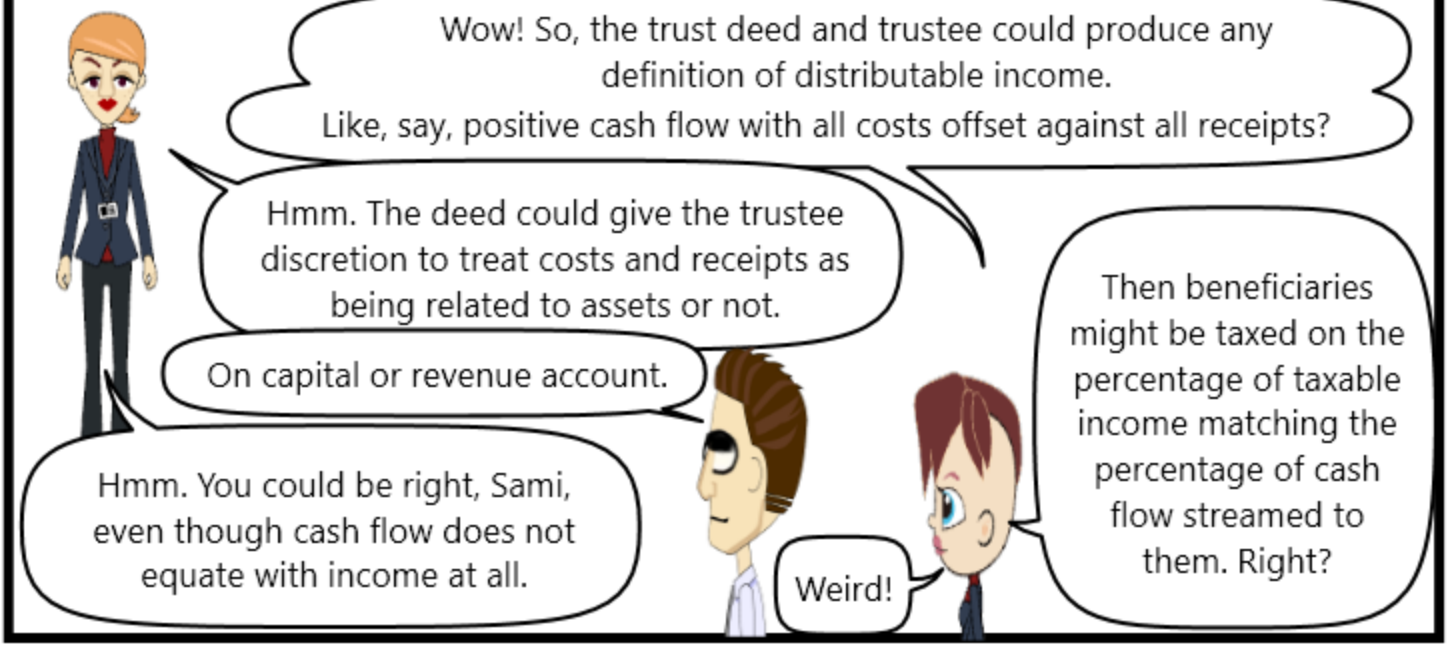
** High Court (2010).

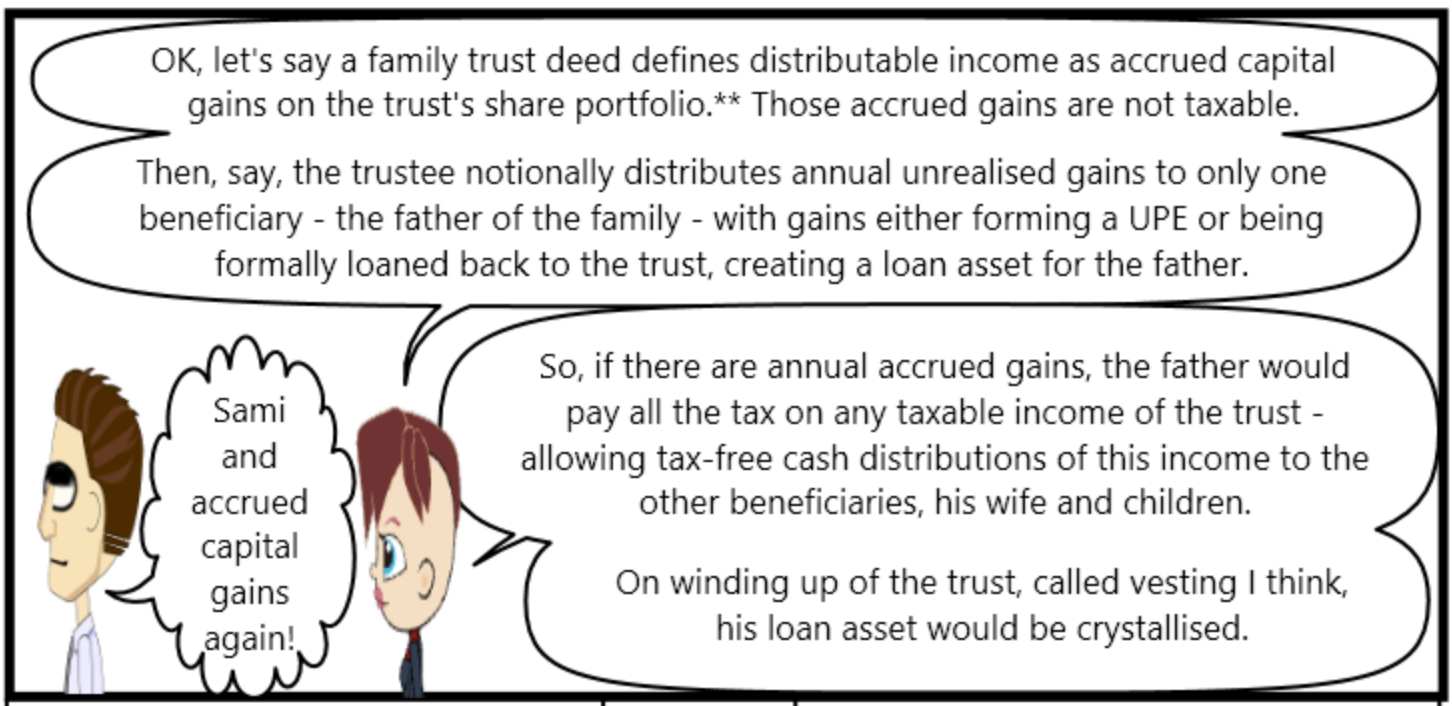
** ATO (2012).

(4) At one extreme, if distributable income is ordinary income and capital gains are not specifically streamed, beneficiaries are taxed on a proportionate basis on overall taxable income (including on capital gains not received by them). If there is no ordinary income, the trustee could then be taxed on any taxable income.

(5) At the other, if a beneficiary is specifically entitled to 100% of distributable income, defined as taxable capital gains, the beneficiary will pay tax on 100% of the trust's taxable income if there are such gains. But, all beneficiaries might receive a share of the trust's retained income as a distribution of corpus.

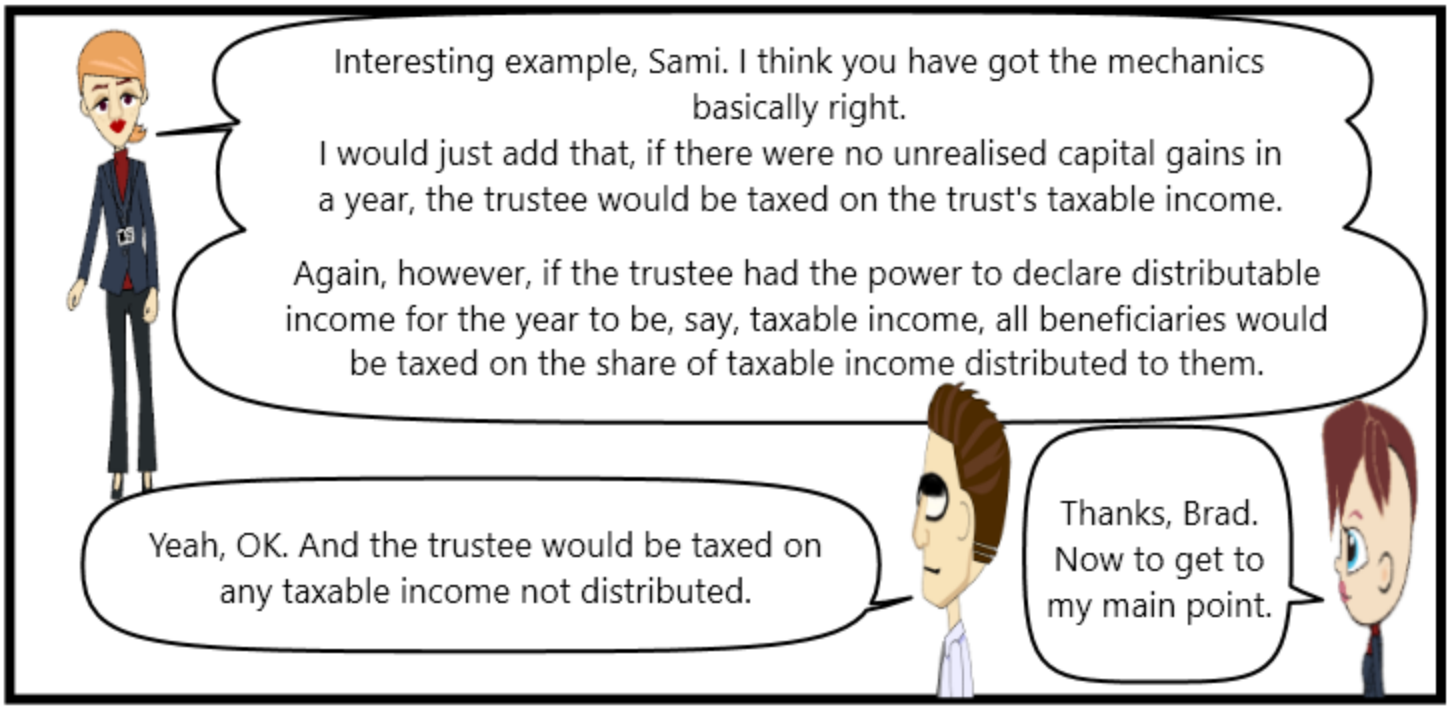


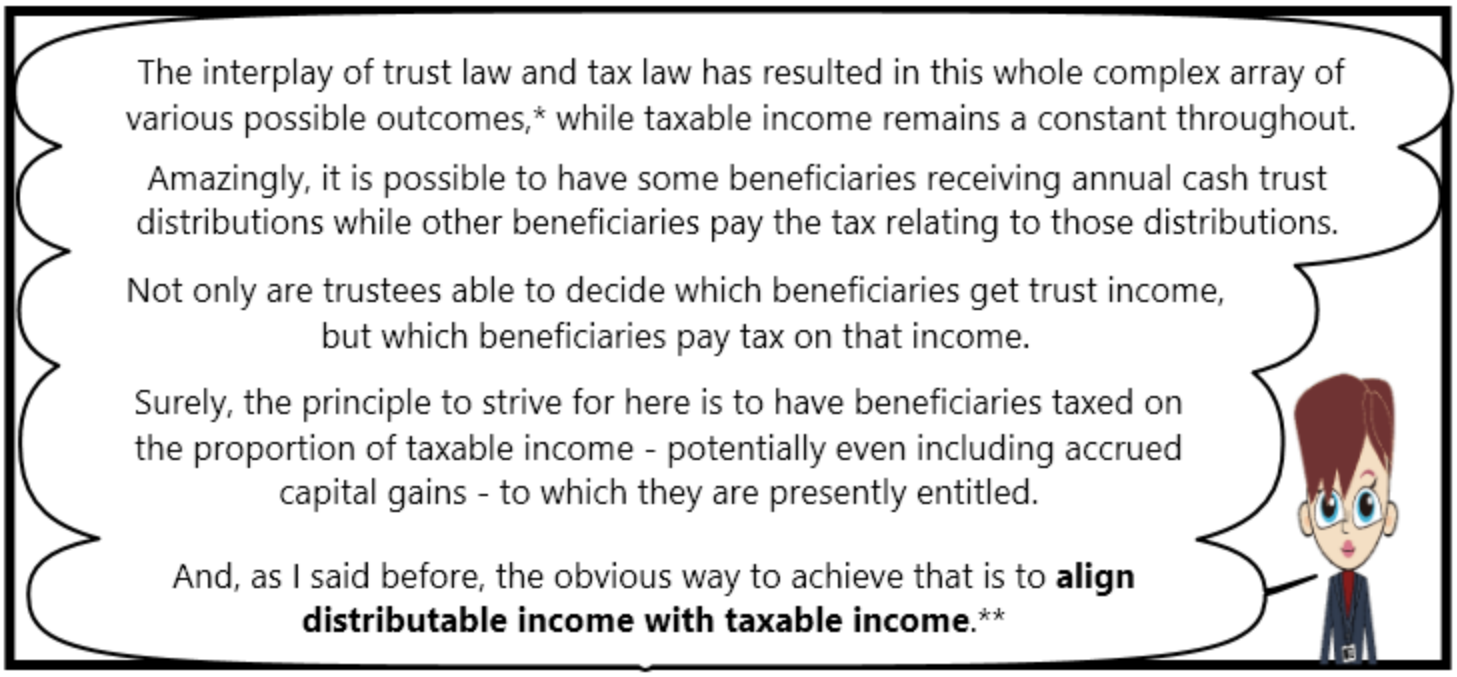


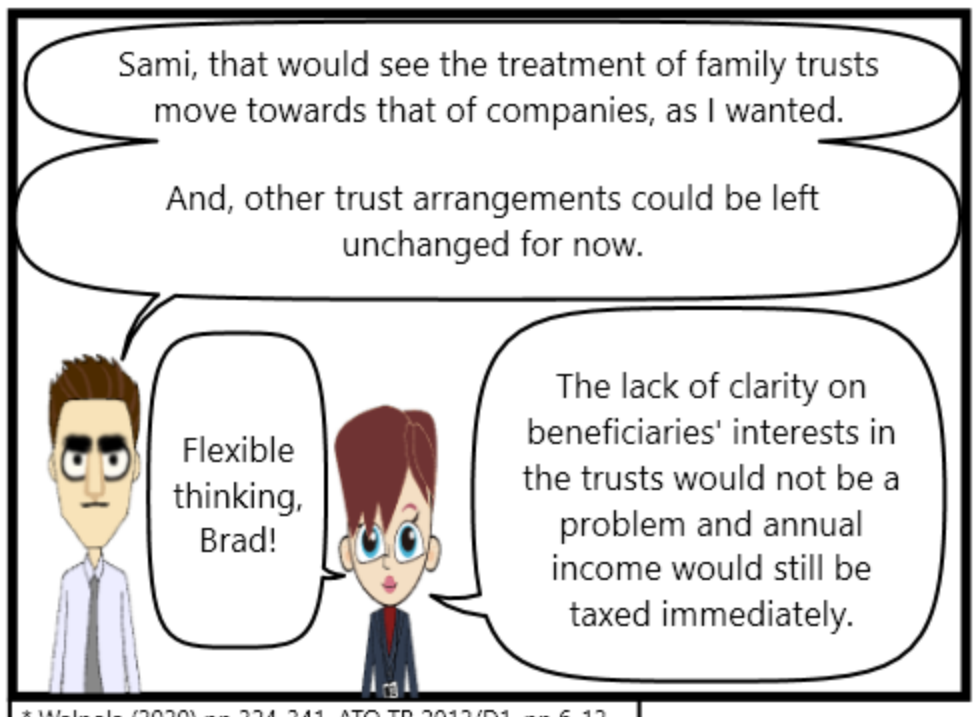


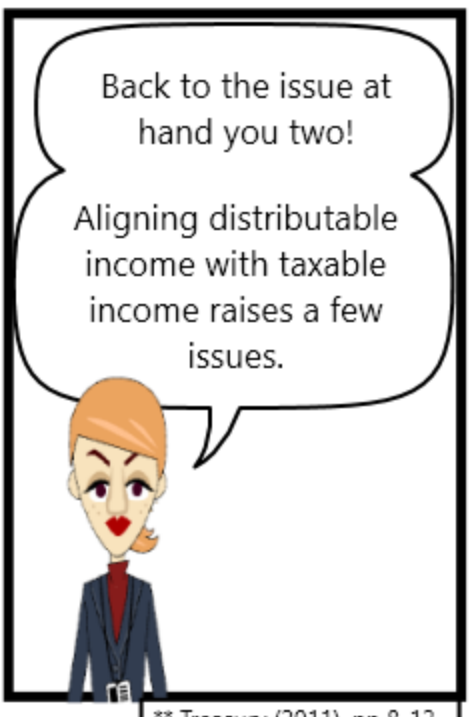
* Worked examples in Walpola (2020), pp 334-341.

** NSW Court of Appeal, Clark v Inglis, 2010, NSWCA 144.



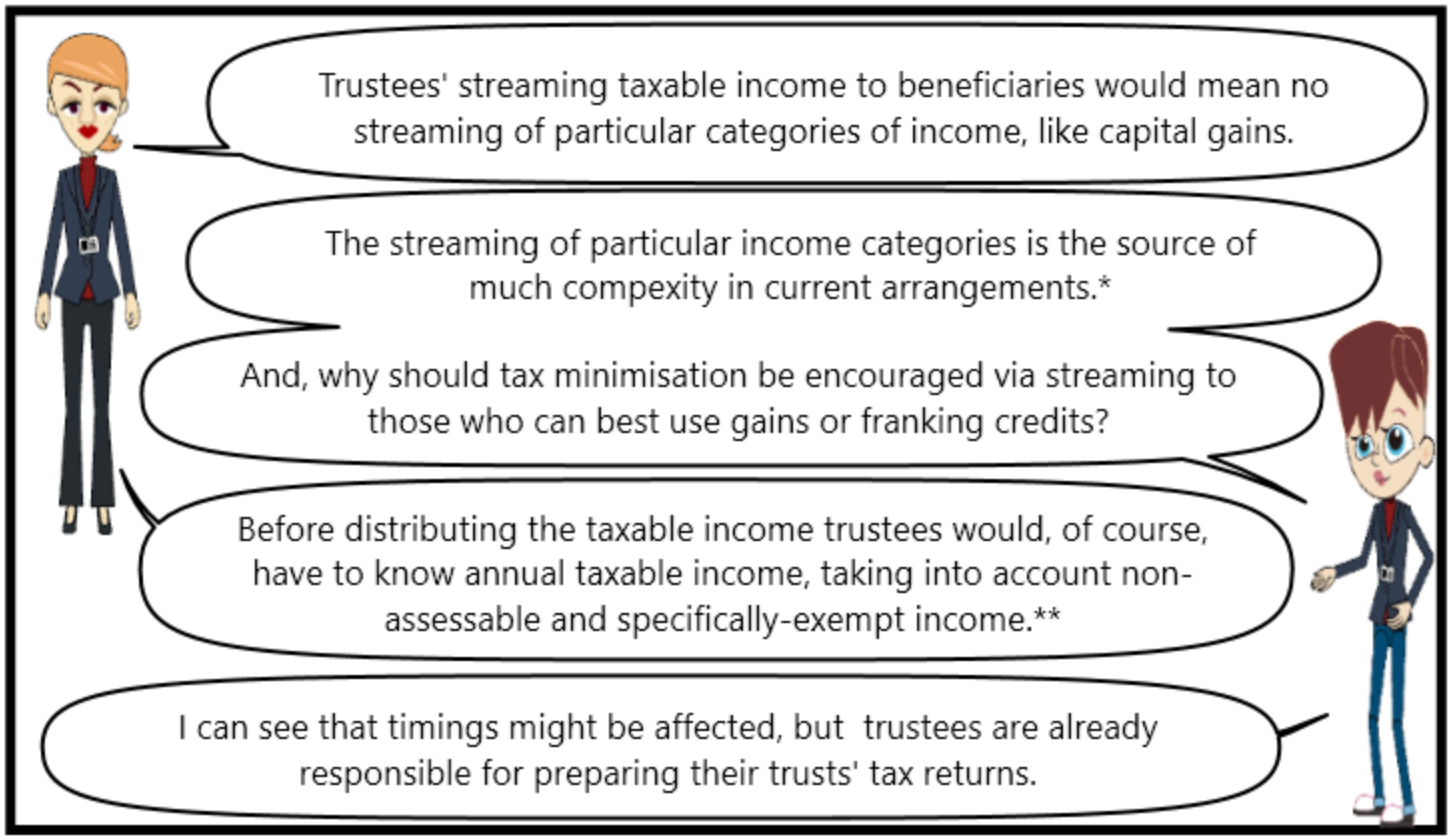


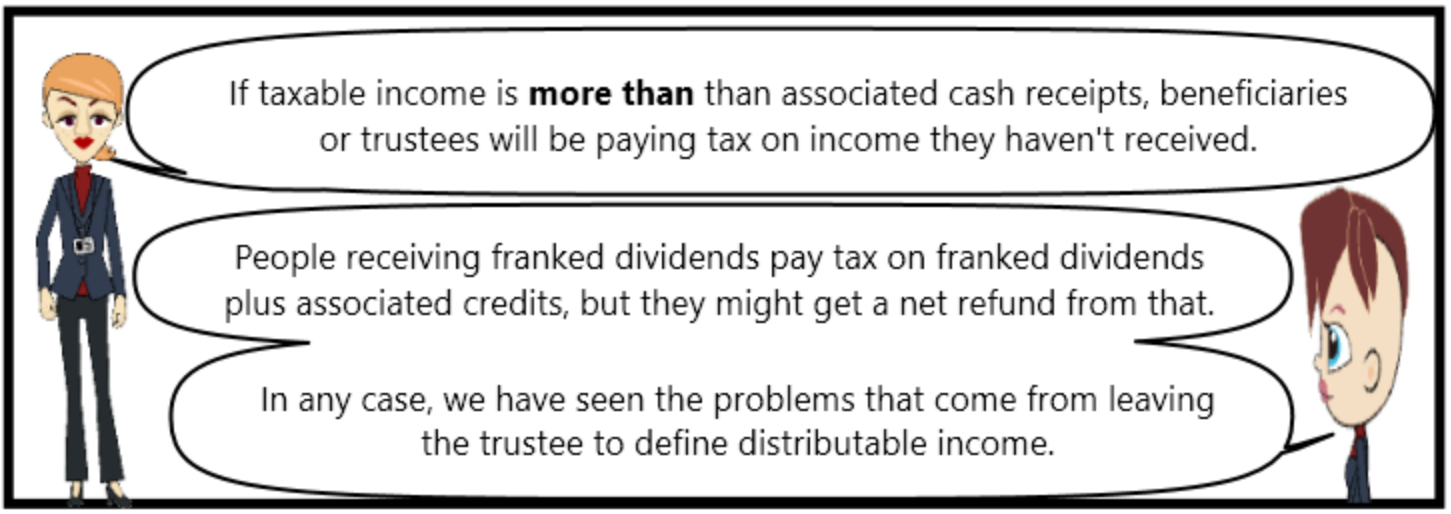


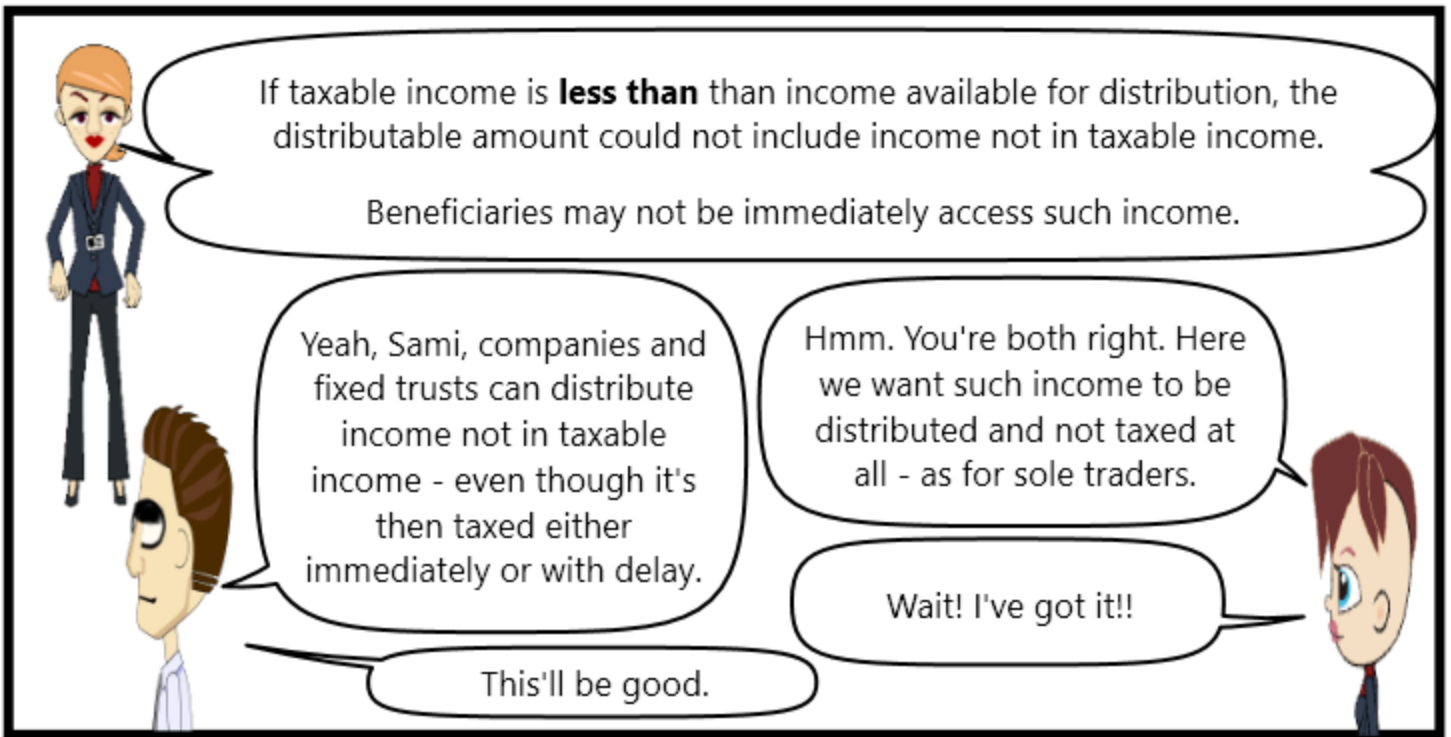


* Walpola (2020) pp 324-341, ATO TR 2012/D1, pp 6-12.

** Treasury (2011), pp 8-12.







* Improved streaming design in Walpola (2020), p 329,335,342.

** Treasury (2011), pp 8-12.

INCOME CATEGORY	CASH DISTRIBUTION	TAXABLE INCOME
Franked dividends	**Cash dividend**	**Franked dividend**
Unfranked dividends	**Cash dividend**	**Unfranked dividend**
Interest	**Interest receipts**	**Interest**
Foreign income	**Cash received**	**Foreign income**
		plus for'n tax credits
Business income	**Net receipts**	**Net receipts**
		plus tax value change
Realised capital gains	**Realised capital gains**	**Net capital gains**
		after discount
Accrued capital gains	**n/a**	**Accrued capital gains**
		beneficiary loan a/c
Non-taxable amounts	**Non-taxable amounts**	**n/a**

In this table, I compare cash distributions versus taxable income across typical income categories.

The non-taxable category includes non-assessable and specifically-exempt amounts.

Total cash distributions across the income categories equals taxable income **less** tax credits and any accrued capital gains **plus** CGT discount on realised capital gains and tax value reduction - depreciation - on business assets **plus** any non-taxable amounts. This is reminiscent of the AMIT regime for unit trusts.*

Unlike an AMIT, however, for discretionary trusts, if cash distributed were greater than taxable income after these adjustments - let's call it **adjusted taxable income** - there would be no extra immediate or delayed tax impost on those distributions.

That is consistent with tax outcomes for sole traders.

And, so ...?

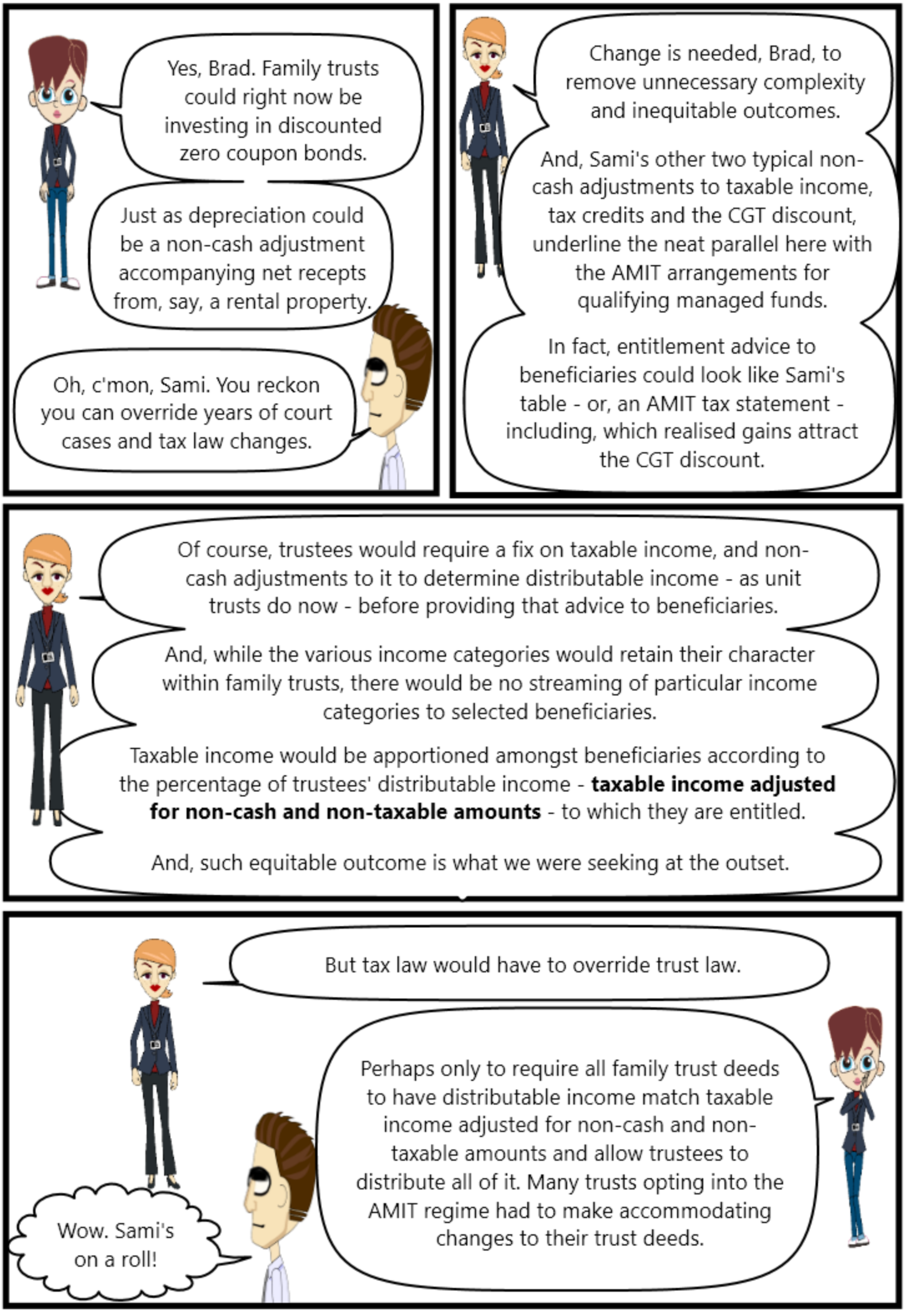
I'm suggesting **distributable income** for family trusts be set at **taxable income adjusted for non-cash and non-taxable amounts**. That would see tax liability follow beneficiaries' entitlements.

Sounds like ordinary income plus realised gains and .....

Depends on what ordinary income actually is.

And, your adjustments include accrued gains, of course!

* Ch6, p 14.


Yes, Brad. Family trusts could right now be investing in discounted zero coupon bonds.
Just as depreciation could be a non-cash adjustment accompanying net recepts from, say, a rental property.
Oh, c'mon, Sami. You reckon you can override years of court cases and tax law changes.
Change is needed, Brad, to remove unnecessary complexity and inequitable outcomes.
And, Sami's other two typical non-cash adjustments to taxable income, tax credits and the CGT discount, underline the neat parallel here with the AMIT arrangements for qualifying managed funds.
In fact, entitlement advice to beneficiaries could look like Sami's table - or, an AMIT tax statement - including, which realised gains attract the CGT discount.
Of course, trustees would require a fix on taxable income, and non-cash adjustments to it to determine distributable income - as unit trusts do now - before providing that advice to beneficiaries.
And, while the various income categories would retain their character within family trusts, there would be no streaming of particular income categories to selected beneficiaries.
Taxable income would be apportioned amongst beneficiaries according to the percentage of trustees' distributable income - **taxable income adjusted for non-cash and non-taxable amounts** - to which they are entitled.
And, such equitable outcome is what we were seeking at the outset.
But tax law would have to override trust law.
Perhaps only to require all family trust deeds to have distributable income match taxable income adjusted for non-cash and non-taxable amounts and allow trustees to distribute all of it. Many trusts opting into the AMIT regime had to make accommodating changes to their trust deeds.
Wow. Sami's on a roll!

RESIDENT TRUSTS

<u>Fixed Unit Trusts</u>

Current design solid

Aligns well with integration company design

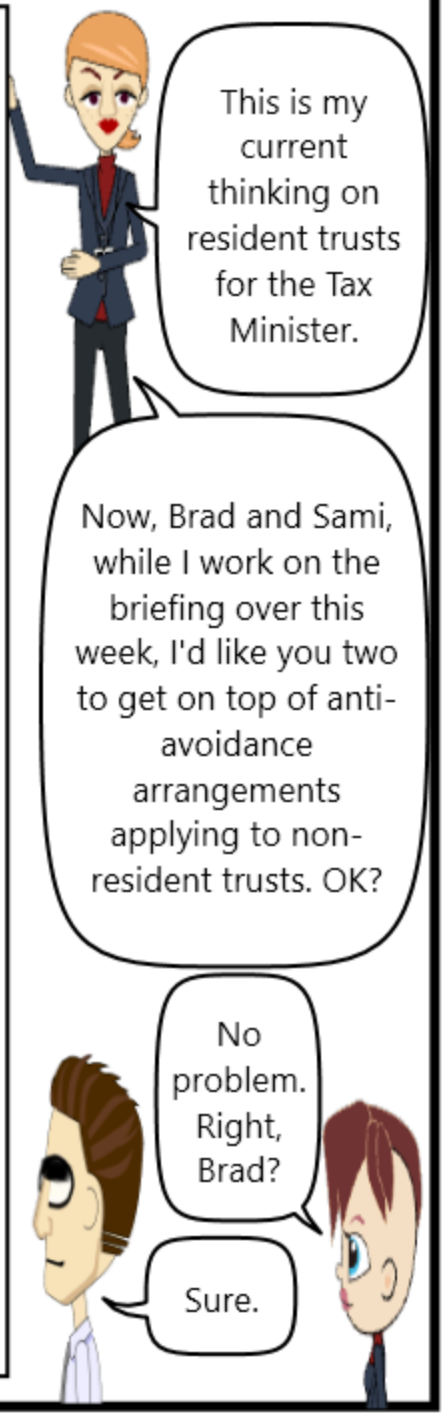
<u>Discretionary (Family) Trusts</u>

Upgrading imputation to integration for companies - would address many costly effects of complex company/ family trust structures

Requiring that trusts' definition of distributable income be trusts' taxable income, adjusted for non-cash and non-taxable amounts - would cut much complexity and excessive flexibility of trustees and align beneficiaries' tax liabilities with their economic entitlements

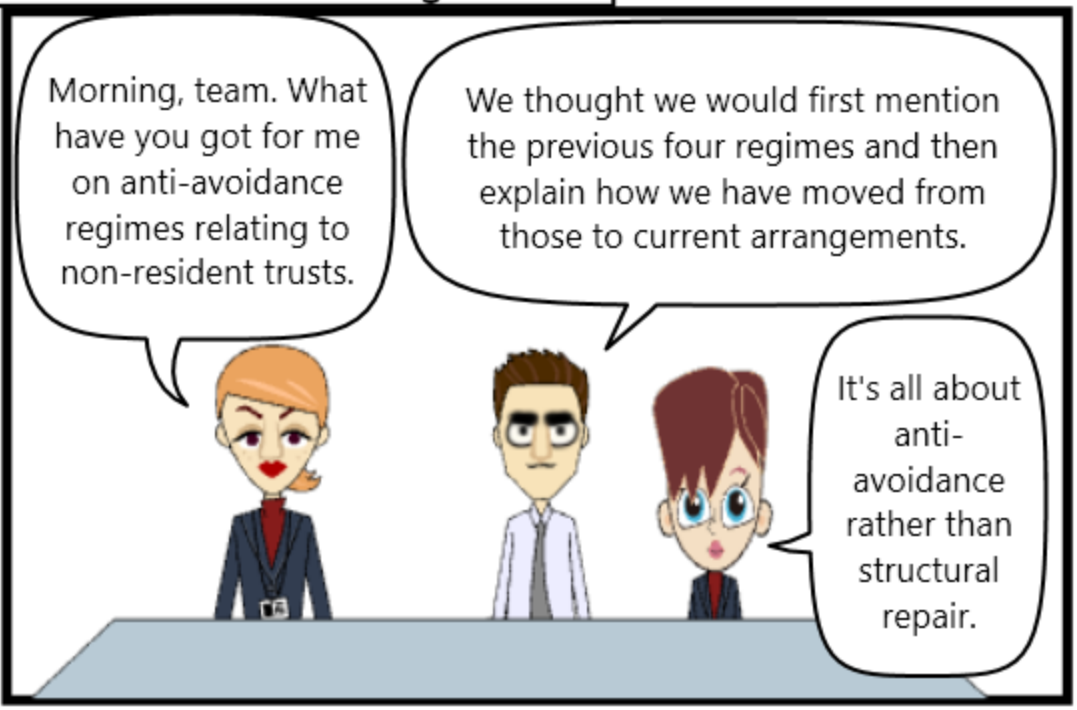
Treating unpaid present entitlements (UPEs) as reinvestment arrangements and, absent integration for companies, refining dividend deeming for shareholders of corporate beneficiaries to achieve equivalent effects to integration - would replace much complexity and uncertainty with principled design

Applying to other family members, like spouses and children, similar measures that currently apply to minor children - would address much tax revenue loss from income splitting but, until other changes are bedded down, continue current integrity measures



About a week later, and the team meets again.....

Interests in non-resident trusts



ANTI-TAX-DEFERRAL RULES: FOREIGN TRUSTS AND COMPANIES - OLD RULES*

1. Controlled Foreign Corporations (CFC) Measures

Tax resident shareholders on their pro rata share of *current* undistributed lowly-taxed 'tainted' income of a non-resident company that is *controlled* (closely-held) by residents (a CFC). 'Tainted' income is mobile income like interest, royalties and dividends.

2. Transferor Trust Measures

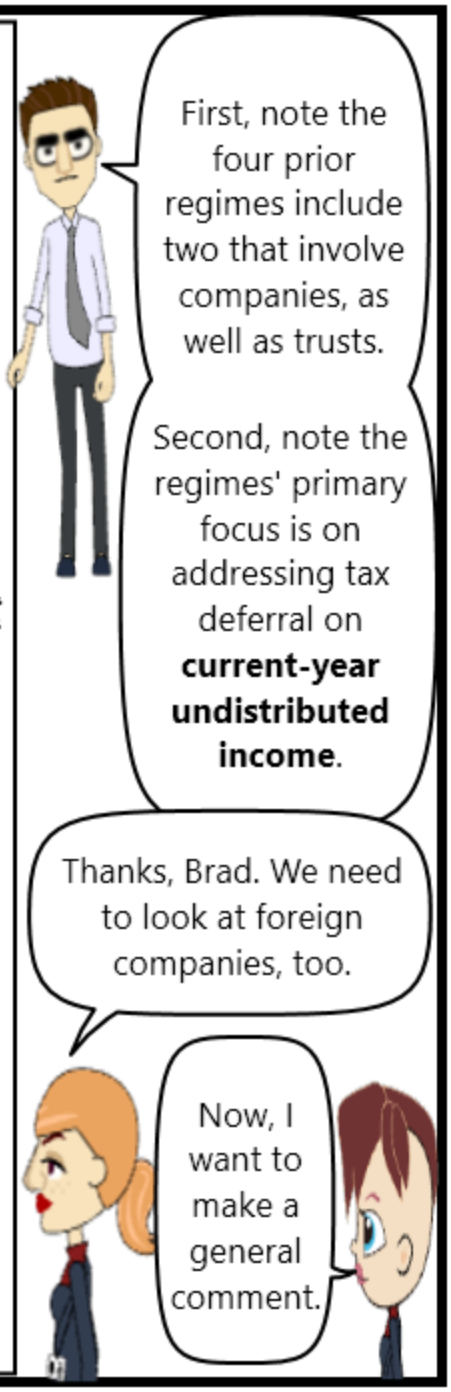
Tax residents, who have transferred value to a foreign trust ('transferors' or '*controllers*'), on *current* undistributed income of the trust - unless already taxed sufficiently. Separately, interest applied to delayed payment of lowly-taxed foreign trust income.

3. Foreign Investment Fund (FIF) Measures

Tax residents on their share of undistributed *current* income of foreign companies or trusts that are *not controlled* by residents - with exemptions for small holdings and company FIFs with active businesses. Three ways to measure income for tax.

4. Deemed Present Entitlement Rules

Tax beneficiaries on deemed share of *current* income - based on rights to get that income later - on their interests in *controlled* foreign trusts and other foreign trusts exempt from FIF measures.

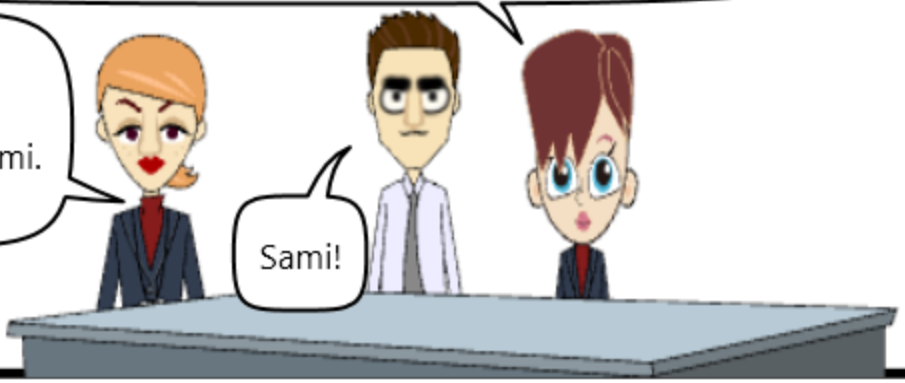


* Ralph Platform, pp 680-681.

It is strange how we have been so keen on taxing current-year income of foreign trusts and companies when there has been little desire to address tax deferral by local companies by implementing integration design.

Interesting observation, Sami.

Sami!



Look, Sami, as we have discussed, locals using foreign trusts to earn foreign-source income just screams tax minimisation.

Absent anti-tax-deferral laws, locals could park investment funds, and income from those, in foreign trusts indefinitely....

....like in foreign transferor trusts into which residents - or 'transferors', who likely control the trusts to their benefit - have transferred assets.

The best way to nip such minimisation in the bud is to attribute current-year income to be taxed, say, to the transferor in the case of transferor trusts.

Similarly, attribution of current-year passive income to local shareholders is the way to go for foreign companies controlled by local shareholders.

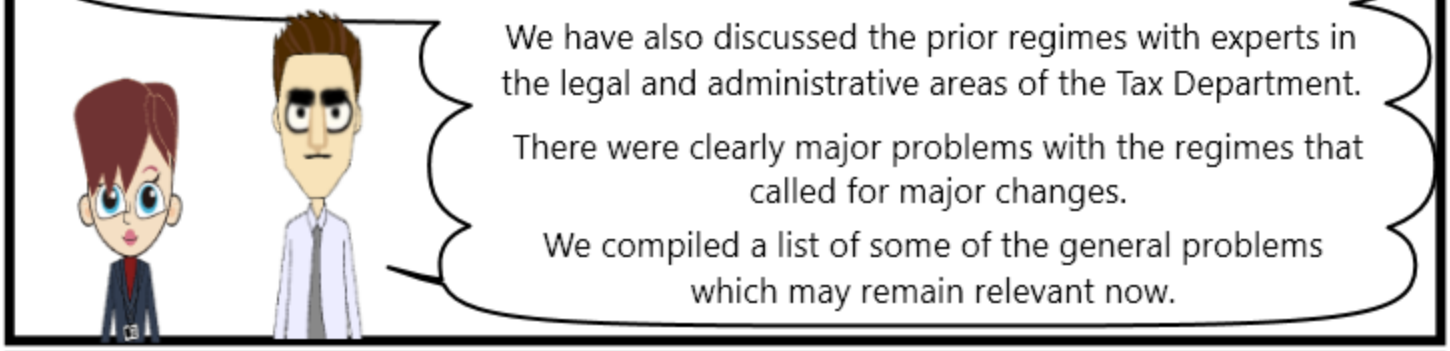
Now, moving on, we thought it would be instructive to explain some of the main problems with the four regimes that led to their being reworked.

For example, fixed, discretionary and hybrid trusts are not each separately allocated to a specific anti-deferral regime.

And, there are blurred boundary lines between the regimes.

Grafting on new provisions over time is the story of many parts of our overly complex business income tax law.

I'm interested - but past detail might not be helpful for the Tax Minister now.



PROBLEMS: PRIOR ANTI-DEFERRAL REGIMES*

Inconsistencies, anomalies and lack of co-ordination between the regimes - regimes seemingly legislated with little sensitivity to coverage of pre-existing regimes

Long and complex rules with ill-defined boundaries that overlap, yet also leave gaps in coverage - there is no mutually exclusive explanation what types of trusts, or companies, each regime is targeting

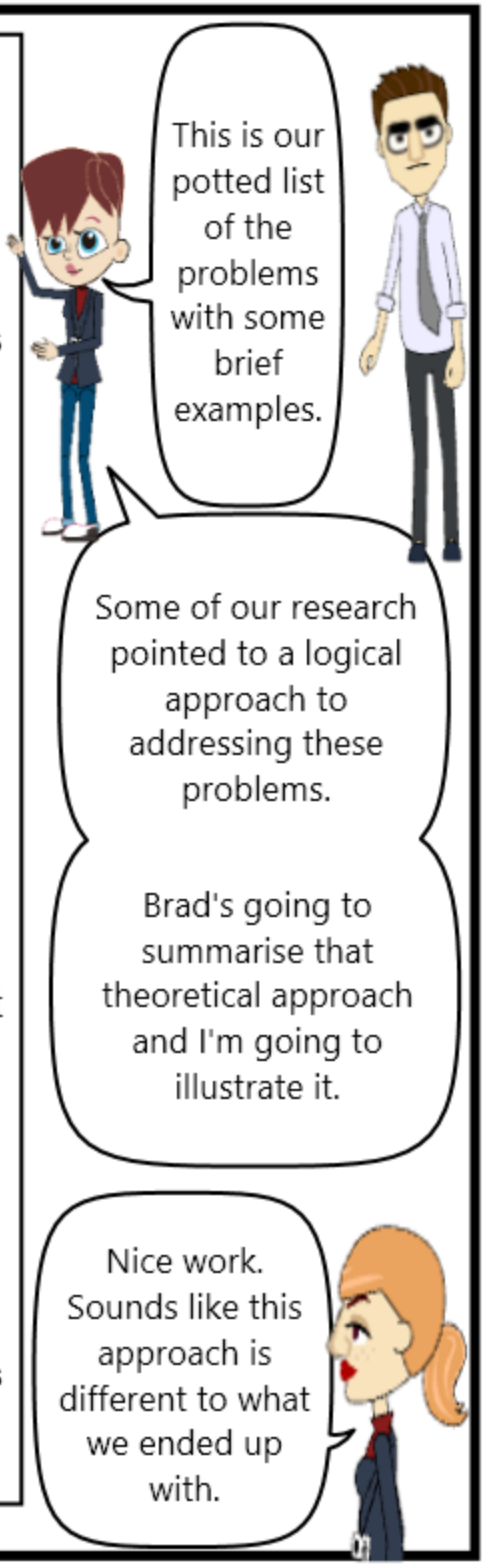
Inconsistent policy objectives resulting in both 'overkill' and easily accessible loopholes - clear design principles are lacking

Inconsistent treatment of similar investments in similar investment structures - even when foreign trusts are structured like companies there are differences between them in income measurement, exemptions, and treatment of foreign and local taxes

Provide unnecessarily generous transition rules - often depend on future actions instead of taxing current income on investments or transfers already made

Local authorities lack access to information necessary to enforce some rules - no point saying income is to be taxed if the income cannot be measured effectively

Some rules simply do not work for discretionary trusts - FIF and deemed present entitlement measures ineffective because cannot determine local taxpayers' current interest, or future entitlement

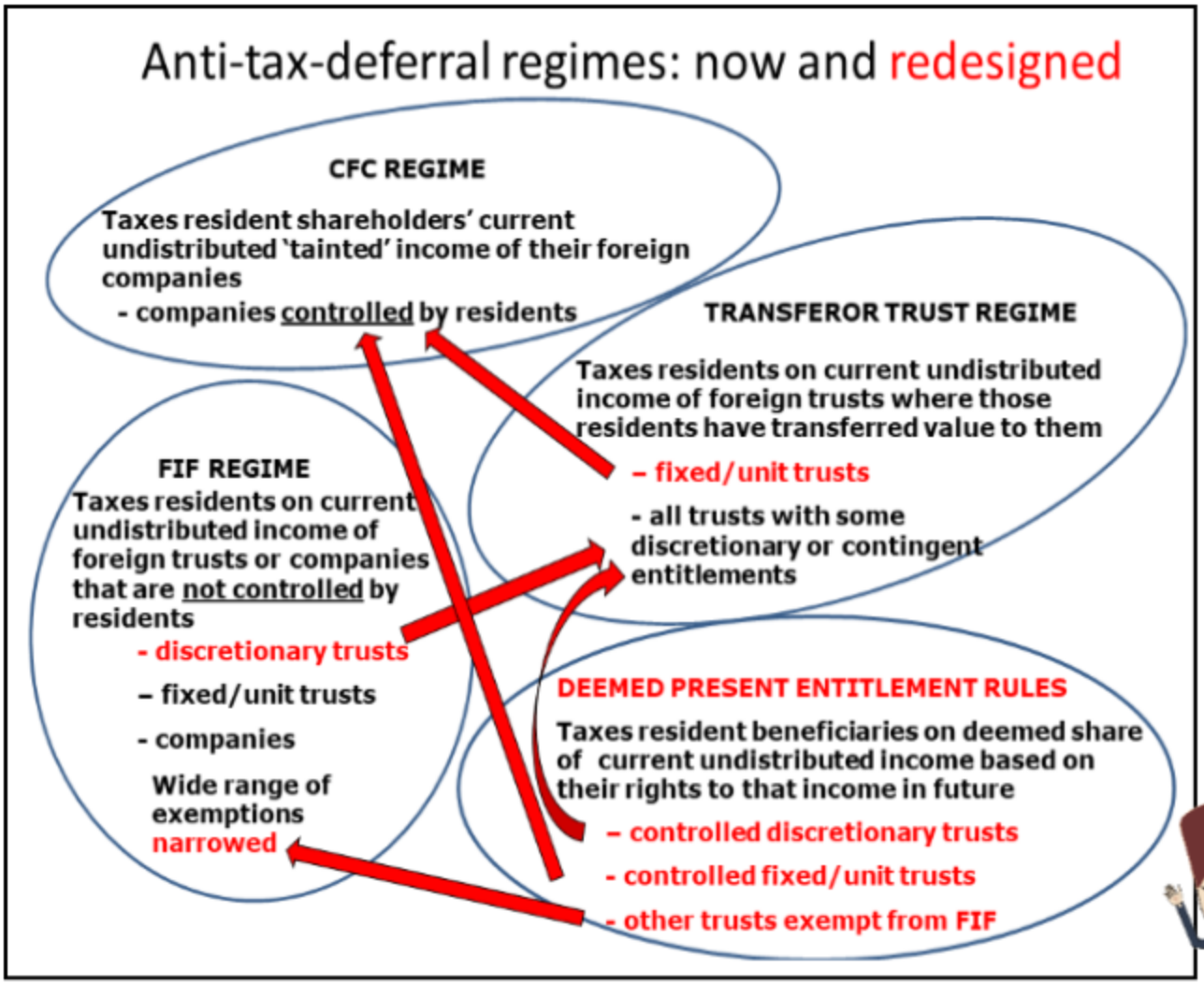


* Identified throughout Burns & Krever.

Basically, under this hypothetical response* to these problems, each type of foreign investment structure is matched to a regime:
(a) controlled companies and fixed/unit trusts are subject to CFC rules;
(b) non-controlled companies and fixed trusts are subject to FIF rules, with reduced exemptions;
(c) discretionary and hybrid trusts are subject to transferor trust rules with all transfers caught; and
(d) the deemed present entitlement rules are abolished.

And, Sami just had to do a chart to illustrate the proposal.

Anti-tax-deferral regimes: now and redesigned



See, the changes in the hypothetical redesign are reflected in red.

Does the chart really help?

Well, I think it's really helpful to get your head around the proposal.

* Burns & Krever, pp 129-135.

Having taken you through all that as background, I can summarise the outcome of government's formal review of anti-tax-deferral regimes for foreign trusts.* Then Sami will again illustrate the outcome with a chart.

In brief, amendments to the law have:
(a) moved **controlled** fixed foreign trusts from transferor trust and FIF regimes to the CFC regime;
(b) abolished both the FIF and deemed present entitlement rules; and
(c) retained the transferor trust regime, with ordinary trust provisions and their present entitlement rules taking precedence in avoiding double taxation.

After the changes, the CFC regime is suggested to be the predominant anti-deferral regime. OK, Sami?

Anti-tax-deferral regimes: new arrangements

CFC/CFT REGIME

Taxes resident shareholders' or unitholders' current undistributed 'tainted' (or passive) income ('attributable' income) of their foreign companies or fixed trusts

- companies controlled (closely-held) by residents

- unit/fixed trusts controlled (closely-held) by residents

Possible ways of calculating attributable income (aiming to match local tax laws):

- change in market value

- imputed rate of return

- direct local law calculation

TRANSFEROR TRUST REGIME

Taxes residents on current undistributed passive or active attributable income of foreign trusts where those residents ('transferors') have transferred value to them

- discretionary trusts (ie not fixed)

- non-discretionary trusts to which 'non-arm's-length' transfers are made

Transfers exempt if on 'arm's length' basis in the ordinary course of business or for units in widely-held unit trusts

Relevant rules after fixed/unit trusts moved to CFC regime and FIF and deemed rules cut:

- CFC/CFT regime

- transferor trust regime

- ordinary trust provisions

Yes, there you are. Without changes shown, a bit simpler than my last chart.

* For Australia, see Board of Tax (2008).

Yes, a simpler structure. Apparently, this was the result of a desire to achieve better balance between integrity, on the one hand, and equity, simplicity and low compliance costs, on the other.

The boundaries between the two remaining regimes are sharp and clear.

And, the transferor trust regime appears to house hybrid trusts that are not solely fixed or discretionary because transfers to discretionary, and particular non-discretionary, trusts are included in that regime.

But, the removal of the FIF regime does beg the question whether there is sufficient integrity over deferral with widely-held companies and trusts.

The arguments for removal of the FIF regime include*: successive new exemptions have resulted in the regime being rarely used or easily avoided; the regime is little understood; and, given local superannuation funds are exempt and a growing source of outwards foreign investment, the regime will become less relevant over time.

I don't know how solid these points are, but I have a bigger picture to raise.

Hang on a moment, Sami. I like the attempt at largely separating discretionary versus fixed trusts into the two remaining regimes.

The new arrangements have controlled foreign trusts that are solely fixed housed within the CFC regime. I presume current-year attributed income of these trusts is usually taxed to resident unitholders.

But, with the transferor trust regime, who gets taxed on current attributable income: the beneficiaries, the trustees or transferors of value to the trusts?

Have you got more detail on the transferor trust regime?

And, what about the interest charge that applies to delayed distributions from all lowly-taxed foreign trusts exempt from attribution? I'm worried that, with no FIF regime, foreign funds with high income retention, like so-called roll-up funds, might be exempt from attribution and people might avoid the interest charge by simply selling out. Roll-up funds offer fixed interests in the capital of the funds.

*Board of Tax (2008), p 11.

TRANSFEROR TRUST REGIME

Local transferors taxed on current passive or active 'attributable' income of:

- discretionary foreign trusts; and

- non-discretionary foreign trusts receiving 'non-arm's length' transfers.

Exemptions include: 'arm's length' transfers for ordinary business or for units in widely-held trusts; deceased estates with no discretion on the transfer; continuous non-resident family trusts (including pre-residence transfers); trusts only for non-residents.

'Arm's length' or dated transfers may still be caught if the transferors have control of the trusts.

Regular trust provisions continue to apply, like:

- distributions/present entitlement of current local or foreign income taxed to beneficiaries;

- retained income taxed to the local trustee; and

- separate interest charges on any delayed lowly-taxed foreign income distributions not caught by the regime.

Now, regarding your roll-up foreign trust funds, Claudia, presumably the new CFC/CFT regime would be taxing locals on their attributable income of such controlled passive-investing funds - but, public unit trusts are exempt.

If exempt from prior attribution, interest charges would only apply to specified concessional or lowly-taxed amounts in ultimately-distributed income.

I presume such interest charges would also apply to delayed entitlements from foreign fixed trusts investing in legitimate 'active' business activities because those trusts would be exempted from attribution now they are housed within the CFC regime.

Now, residents, who avoid interest charges by selling their units in widely-held roll-up funds exempt from the CFC/CFT regime, should have interest charges added to their CGT with no discount allowed.

Having said all that, I'm now wondering why the interest charges don't apply to foreign companies, as well as trusts.

OK. Sorry, Claudia, but I really must jump in now.

What I see in the attribution provisions aimed at foreign trusts and companies is nothing short of amazing.

The anti-tax-deferral rationale of these provisions matches the general neutrality design principle of taxing individual residents on their taxable current-year investment income - consistent with what already applies with local trusts and our hoped-for integration design for local companies.

What I don't understand is the lack of any concerted push here to introduce integration for local companies to address the common blatant, distortive and costly deferral of personal tax on our companies' taxable income - particularly when there is ready access here to information for income measurement, in contrast to the foreign scene.

Moreover, where current-year income of foreign trusts is not caught by our attribution regimes, interest charges might apply to delayed distributions of that income if the income has been lightly taxed in the foreign countries.

Consequently, trust income attracting foreign concessional treatment - and I include prior untaxed capital gains in this - may be subject to the interest charge when ultimately distributed, even if the foreign country imposes comparable tax rates to us.

And, if the foreign country is a low-tax country, the interest charge could apply to all of the delayed foreign trust income. Any foreign tax paid in either circumstance is taken into account.

Conceptually, applying such interest charges to deferred distributions of taxable income of local companies would immediately turn our company tax system from imputation to integration.

And, if the interest charges applied to prior accrued capital gains, the company tax design would be pushing towards integration of economic income, not just taxable income.

I know this is all a bit of a stretch, Claudia, but the broad gist of the foreign trust rules highlights the timidity of local tax rules for both companies and capital gains.

I like your thinking, Sami, and.....

These two purists again!!

Sorry, just one more thing, Claudia. Reverse thinking would say apply the integration ideal to all locally-controlled foreign companies and fixed trusts, replacing the CFC/CFT regime and allow no exceptions, like the current active business one.

Then, CGT tax value adjustments, for example, would apply to local shareholders of such companies, as under integration design, and to local unitholders of such trusts, as under our AMIT system.

The transferor trust regime would still deal with foreign discretionary trusts because of no tax values on trust interests. And, interest charges would apply to delayed local distributions that might come from such trusts initially settled by non-residents.

Time for reality check, Sami.

Sami, I really like your conceptual thinking and enthusiasm.

But, the difficulty remains of ready access to required data to determine foreign-source current-year income. Moreover, having integration law here would not make foreign tax authorities respond, say, by converting retained taxed income into contributed capital with accompanying CGT advice.

Sure, the attribution regimes do not always guarantee no double tax or double deductions. But, despite the constraints in the international scene, current-year attributable income taxed here should not be taxed again here. And, it is logical to focus on the key deferral opportunities while not getting too much in the way of locals' foreign investment decisions.

We could push for integration elsewhere.

Nevertheless, I very much like your equating my proposed integration design for local companies with our attempts at taxing local residents on current-year attributable income of foreign trusts and companies.

As you say, that is all consistent with our ideal policy design of taxing local individuals on their current-year income across all investment vehicles set within our country's taxing of the worldwide income of residents.

I'm thinking there are two lines of discussion I could include in the Tax Minister's briefing based on the really hard work you two have put in on this topic.

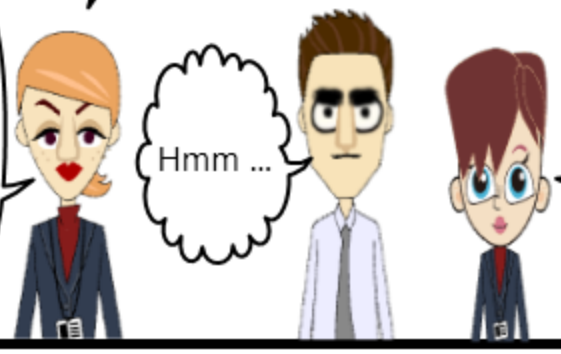
Not all this theory please!

Exciting!

First, I could make your point, Sami, about our one-eyed focus on international anti-tax deferral to bolster the case for applying integration to companies here.

Secondly, I could briefly draw on some of the problems you explained, Brad, with our past anti-tax-deferral regimes when describing the remaining two regimes, perhaps using Sami's chart.

And, against that background, I could suggest a review to assess whether or not the changed arrangements adhere to what you have helped me confirm are relevant key policy principles - and raise related reform questions.



POLICY DESIGN PRINCIPLES: ATTRIBUTION REGIMES*

(1) Tax locals' current-year foreign trust income where practicable - as per over-arching tax-neutrality ideal.
Apply interest to deferred distributions of foreign companies?
Apply rules to all existing investments/transfers?

(2) Need mutually exclusive definitions of regimes - each specific to clearly defined structural types of trust.
Does transferor trust regime deal well with hybrid trusts?
Does CFC/CFT regime deal well with roll-up or accumulation funds - if exempt, should not interest apply to CGT on sales of interests with no CGT discount?

(3) Have strong rules for reporting foreign transfers and subsequent income details. Given difficulties checking foreign transactions, are current rules strong enough?

This is what I've got on policy principles of foreign income anti-tax-deferral regimes, with a few questions.

Notice the first principle, Sami.

OK, I'm off to work on this part of the briefing.

We will get to life insurers and co-operatives shortly.

Sami, could you prepare to start our discussion off with co-operatives, please?

This is all too much for the Tax Minister!

Another exciting day in the world of tax!

Certainly, Claudia.

* Consistent with Burns & Krever, pp 129-130.

The team meets again a few days later.....

Co-operatives

OK, what have you got for us on co-operatives, Sami?

As I mentioned to you earlier, I think we will just need key points for the Tax Minister's briefing.

Right.

Co-operatives are legally incorporated, limited liability entities set up to serve the interests of their members.

They may operate in most goods or services sectors, providing benefits to members as a priority over making high profits.

Regardless of the size of their shareholdings, active members have an equal vote at general meetings, run by boards of directors.

Members might form co-operatives to operate together for their own benefit, say, as customers or producers of particular goods or services.

Members receive specific benefits as rebates or bonuses, perhaps based on business activity with the co-operative, or as dividends on their shares with distributing co-operatives.

Distributing, or for-profit, co-operatives have share capital with members owning shares and may distribute profits to members. They are taxed like regular companies, though with notable differences regarding distributions.

Non-distributing co-operatives may issue shares or charge members annual subscriptions but their profits just further their objectives and are not distributed. They fit the tax definition of not-for-profit organisations and may be tax-exempt.

Co-ops trade with members and others, like other businesses - and all should be taxed like companies.*

Our focus is on for-profit co-operatives and I have prepared a summary of how their distributions are taxed.

I'll show you what I've got.

* Ralph Review, pp 471-472.

TAX TREATMENT OF CO-OPERATIVES' DISTRIBUTIONS*

For-profit co-operatives decide whether their distributions are to be franked (subject to available franking credits) or unfranked and members are taxed on them like company shareholders are on their dividends.

Sources of distributions - distributions may be from: current-year assessable income distributed as rebates or bonuses, based on members' activities with their co-operatives, or as dividends on members' shares; non-assessable profits (like gains on pre-CGT assets); or, retained prior-year profits.

Franked distributions - these are distributions to which available franking credits are applied. So, with co-operatives taxed at 30%, $3,000 of franking credits could be applied to $7,000 of, say, current-year assessable income to achieve a fully franked distribution of $7,000.

Unfranked distributions - these are distributions to which no franking credits are applied, even if the company has available franking credits. If such distributions are out of current-year assessable income they are deductible to the company (and assessible to members). No deduction applies if the distribution is not out of current-year assessable income.

Partly-franked distributions - these arise when franking credits are applied only to part of a distribution. If the distribution is not all funded by current-year assessable income, the franking credits are first applied to any of the distribution not sourced from such income (to maximise the amount deductible to the co-operative).

* ATO (2016).

* Ralph Platform, pp 507-514.

** Ralph Review, pp 471-472.

I certainly agree that there is no economic justification for allowing deductions for loan principal repayments.

We should suggest abolition even though prior attempts at abolition have not been successful because of the regional dimension.

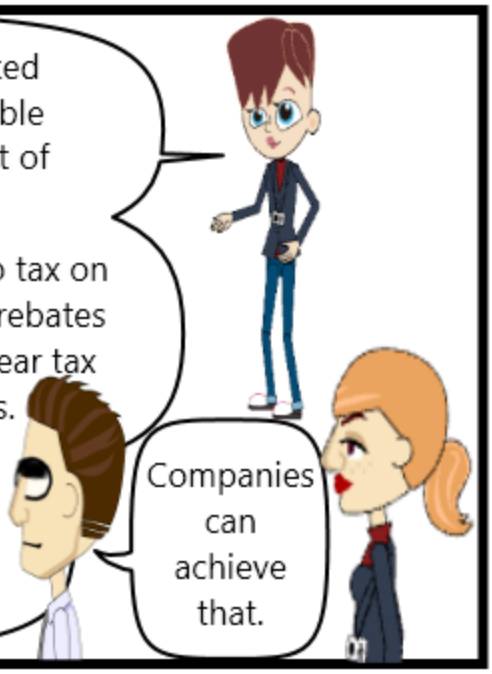
And, you know me, Claudia, I'm all for consistency of treatment of business entities. And, taxing co-operatives as companies would bolster simplicity.

Nevertheless, current design for co-operatives encourages their current-year taxable income to be distributed in full to be taxed at members' tax rates - whereas current imputation design for companies does not provide the same encouragement.

You see, imagine a co-operative that funds an unfranked distribution out of the amount of current-year assessable income that exceeds allowable deductions - that is, out of assessable income that matches taxable income.

The co-operative gets a matching deduction and pays no tax on the annual taxable income paid out to members, say, as rebates or bonuses. Members, often on low tax rates, pay end-year tax at their marginal rates on those rebates or bonuses.

This matches the outcome when trusts distribute annual income to beneficiaries or unitholders. And, like trusts, co-operatives have an incentive to achieve this outcome.



Yes, Brad, under imputation, companies may, of course, distribute annual taxable income - as franked dividends plus franking credits.

But, as you explained yourself, the equivalent of early refunds of franking credits would be needed for low-income shareholders to avoid waiting to lodge returns to get their refunds of excess tax taken off their dividends.

And, of course, **imputation** does not itself provide any specific incentive to distribute current-year income immediately.

In contrast, **integration** design would automatically allocate current-year taxed income to members of co-operatives - but, again early refunds would be need to avoid intra-year cash flow effects for low-income members.


OK, Sami, I think I can see where you are going with this.
Yes, Claudia, applying your integration design to for-profit co-operatives, with a smooth system of selected early refunds of franking credits is the ideal way to go - meeting simplicity, consistency and neutrality goals.
Simplicity and consistency is imputation applied everywhere.
OK, Brad. Now, Sami, proposing integration for co-operatives immediately is questionable.
You bet it is!


Consistency would require, first, achieving the very challenging agenda of getting approval for, and applying, integration to companies.
And then working through the specific issues involved in applying integration to for-profit co-operatives.
Hmm....


I think I've got enough for the Tax Minister's briefing - both on deductions for loan interest payments and bedding down integration design for companies generally before spreading it to co-operatives.
OK. That will do today. I'll add co-operatives to the briefing. I'll get us started on life insures tomorrow.


Excuse me, Claudia, I remember you saying that we should push the ideal for the best chance of good outcomes.
What is it, Sami?

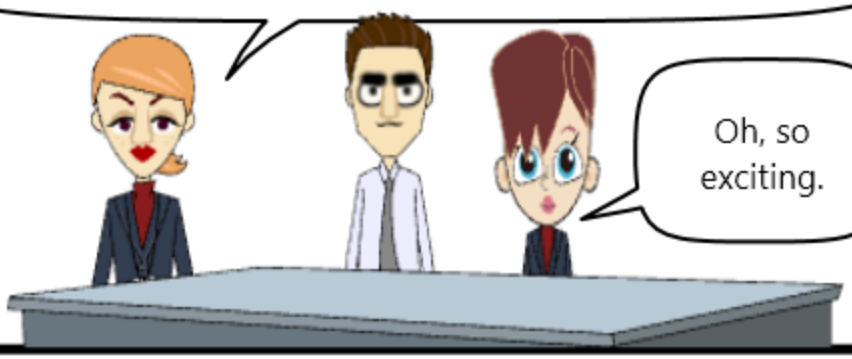

I think we should include for-profit co-operatives now within our proposed integration system.
Love your enthusiasm, Sami, but remember if you push too hard, especially without full preparation, you might lose all.
I'm not pushing to hard am I?

Next day, the team gets straight into life insurers.....

Life insurers

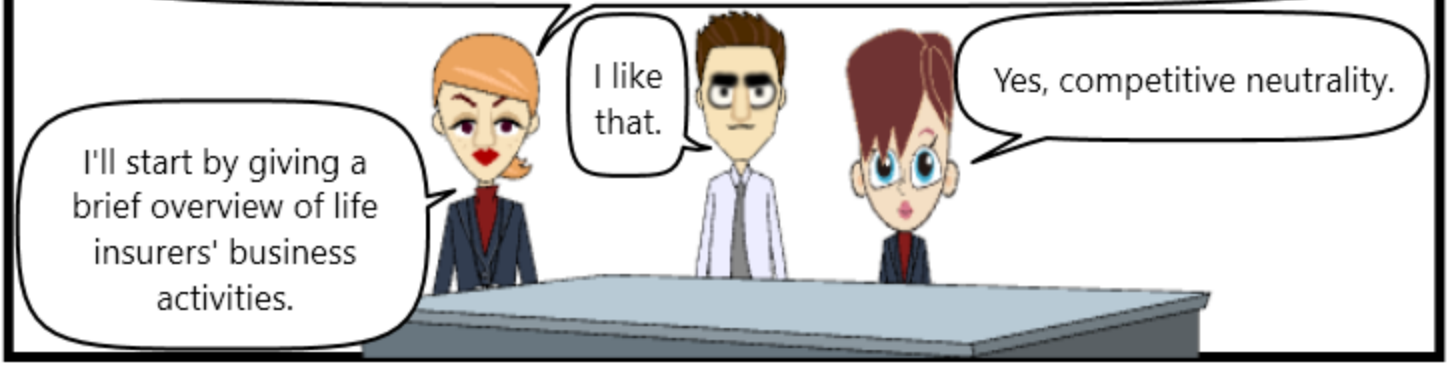
For the Tax Minister, I want to cover key points on the income tax treatment of life insurers; that is, life insurance companies and friendly societies.

I will do that by looking at life insurers and their policyholders, as well as their shareholders because life insurers invariably structure themselves as companies.



Recommendations of Australia's last wide-ranging review of the tax treatment of investment income led us to a major reworking of our own prior regime for taxing life insurers.* That regime was very messy.

The new regime seeks to tax the various activities, or income streams, of life insurers in like manner to comparable activities of other taxpayers.**



I've tried to emulate Sami's charting skills to summarise the three categories of life insurers' business activities: risk business, investment business and superannuation business - touching on associated income tax treatment.

Some policies offered by life insurers combine their risk and investment activities.

* Ralph Platform, Chs 34, 35; Ralph Review, Section 14.

** Treasury (2018), pp 2-3.

LIFE INSURERS' BUSINESS ACTIVITIES

1. *PURE RISK BUSINESS*

Life insurance policies

– policyholder pays premium for period of coverage

. and pays no tax on payout

- insurer agrees payouts for covered policyholders on:

. death

. serious disability

Insurer risks payouts exceeding claim predictions

Insurer taxed in line with general insurers

COMBINED RISK AND INVESTMENT POLICIES

- risk policy: agreed payout on death or disability

- whole-of-life or prior maturing endowment policies providing on cancellation or maturity:

. return of contributions

. plus bonuses

2. *INVESTMENT BUSINESS*

Investment-linked policies

- like unit trusts retaining earnings

Investment account policies

- like bank account with no withdrawal

Insurers taxed on annual investment income

Policyholders taxed only if policy cancelled or matures less than 11 years in

Annuities (regular payouts)

- insurer not taxed when annuitants are

3. *SUPERANNUATION BUSINESS*

Superannuation policies

– can include annuities

Tax treatment of insurers and policyholders aligned with that of superannuation funds and their members

Here are insurers' three business activities with associated policies highlighted in red and brief references to tax treatment. Their combined risk and investment policies are shaded green.

You can imagine the insurers' receiving insurance premiums, superannuation contributions and investment monies - then investing those funds to support payouts under the various policies.

Woow. A dump of information!

That's great. I've got some questions.

Hold the questions, Sami. We will go through each business activity in turn, starting with insurers' pure risk business.

Life insurers' pure risk policies

The core activity of life insurers is their risk business which involves accepting payments, or premiums, from policyholders for periods of cover, in return for agreeing to provide specified sums to covered policyholders on events such as death, disability and trauma.

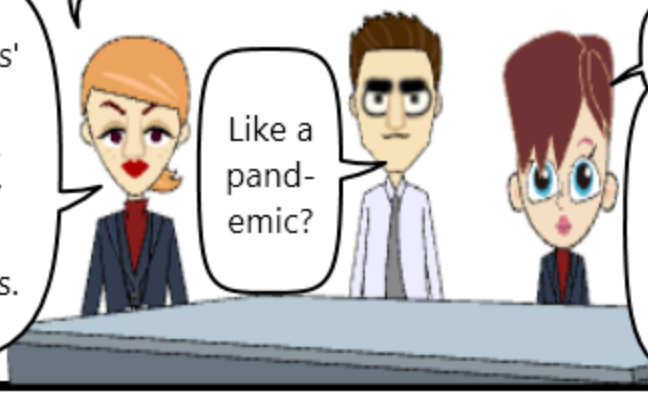
As the chart says, insurers take on the risk that annual payouts exceed their prior expectations of claims.

Underwriting profits from this risk business are sought from the streams of premiums for cover set against payouts triggered by insured events.

You can see that risk analysis, including assessment of age, health, occupation and lifestyle of potential policyholders, is useful in setting premiums to produce ongoing underwriting profits.

Life insurers invest annual surplus cash flow from risk premiums received net of policy payouts, taxes and administrative and selling costs. Earnings from the investments help cover future payouts and bolster overall profitability.

Premiums add to the insurers' income and higher net liabilities take from income. Unexpected influences may put a gap between annual claims and prior expectations.



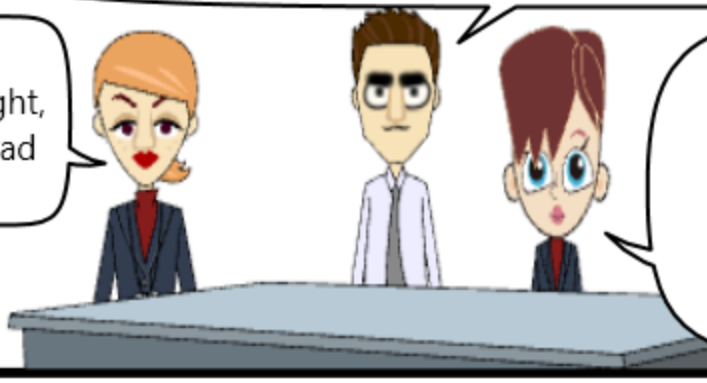
Good one, Brad.

With solid actuarial work needed I reckon to change claim predictions.

As you said, Claudia, with risk policies, an insurer accepts the liability to make a lump sum payout to a policyholder once a premium is paid for a period of cover.

The insurer obviously has to manage the varying risks across all of its risk policyholders - including taking into account people ceasing their life policies as they build up their wealth from, say, home ownership and superannuation.

Right, Brad



Wow, to estimate the value of their risk policy liabilities right now, life insurers would have to bring forward to the present estimates of future payouts and associated costs taking into account a myriad of considerations.

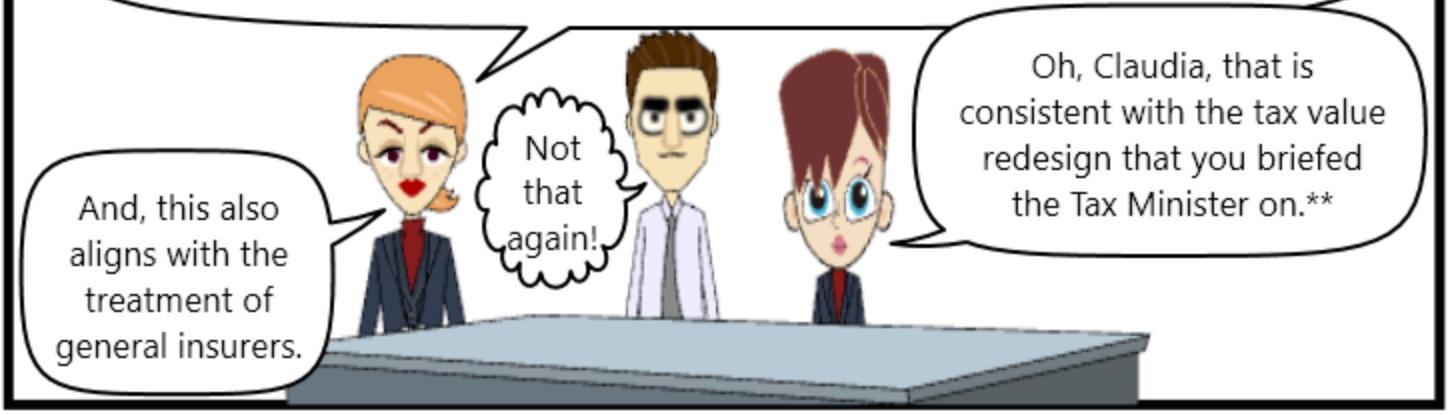
That's right, Sami, essentially, life insurers calculate their risk business liabilities to policyholders on an approved actuarial basis across their large pool of policyholders as a whole.

As noted, risk policyholders' benefits, or payouts, only arise when the insured events occur and policyholders may halt premiums at any time.

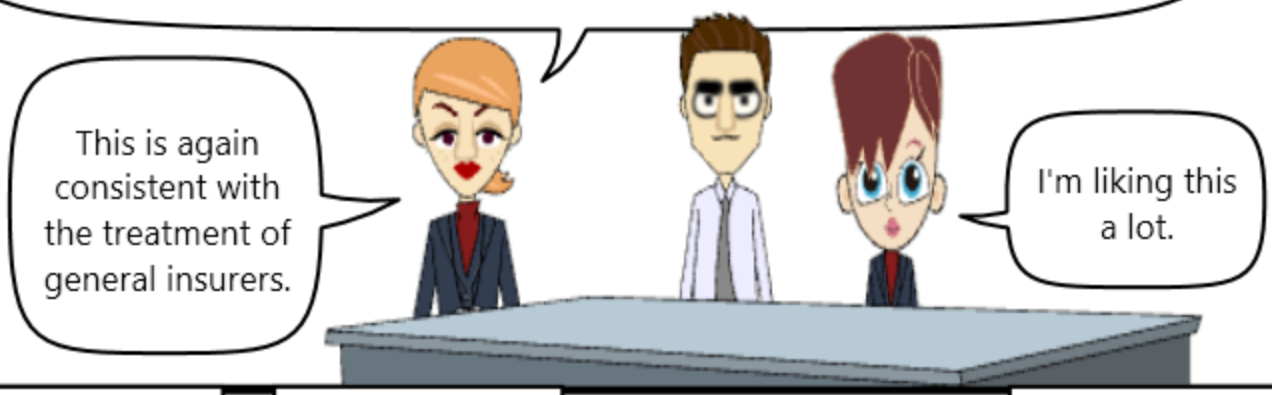
And the insurers' measure of expected benefit payouts for a year is also based on approved actuarial calculations of the limited number of insured events likely to occur - and the estimated level of associated payouts involved - across the whole pool of policyholders. Again, all this is consistent with calculations for general insurers.

After those recent improvements to tax design, the annual change in value in risk policy liabilities now feeds directly into life insurers' taxable income.

Each year a life insurer's taxable income from its risk business essentially comprises: premiums less payouts and associated costs - or **cash flow** - less any increase, or plus any decrease, in **value** of risk policy **liabilities**; plus, the taxable income generated from assets essentially funded from premiums and retained earnings to support the risk business.*



Also, life insurers' yearly taxable income takes into account costs and policy premiums that need to be spread over the tax years of associated policy coverage. In other words, costs and premiums need to be aligned with the income years of associated risk coverage.*



* Ralph Review, pp 490-492.

* Treasury (2018), pp 3-5.

** Ch1, pp 28-38, 40-41.

Our discussion has highlighted the importance of getting a good fix on the value of life insurers' **risk liabilities** at start and end of the income year.

Crucial to this are the links in the tax law to our prudential regulator's standards for estimating life insurers' annual risk liabilities.

What I particularly like is that, consistent with tax value design, taxable income simply amalgamates all the insurers' cash flows from their risk policies with changing tax values of associated assets and liabilities - with actual payouts reducing, and associated reduction in liabilities increasing, taxable income.

But, clearly, annual change in risk liabilities is a dynamic thing. After the prior actuarial estimate of number and amounts of annual payouts comes the actual payouts, as well as new policyholders with their new liabilities and policyholders who decide they no longer need risk cover.

The net effect might be little change to value of risk liabilities over the year.

So, look, I reckon I can summarise how annual taxable income of an insurer's risk business comes together - to then be taxed at the company rate.

Risk business taxable income

Risk premiums paid by all risk policyholders for current year's cover (incl renewals and new policies)	**Cash flow**
-	
Payouts for claims over covered events plus claims admin costs	
-/+	
Increase/decrease in actuarially estimated value of claims	**Value change of liab-ilities**
+	
Taxable income out of investment income from assets held to support risk policy liabilities/payouts	

See - policy premiums plus investment earnings seek to cover claim payouts.

And I love how risk taxable income is: cash flow and change in value of risk policy liabilities.

Neat, Sami.

But what about the policyholders?

I tried to indicate on my summary chart that, usually, no tax applies to benefits received for insured events - even if the payment is on a policy that includes an investment component. That calls for a closer look at the insurers' investment and superannuation policies.

As noted, investment policies of life insurers may be separate policies, or bundled with risk products with consequent effects on the size of premiums.

EXAMPLES OF INVESTMENT POLICIES*

Investment-linked policies - premiums paid buy units in a pool that invests across a typical range of possible investment assets, like equities and property. Policyholders bear the investment risk, with any 'bonuses' realised on ultimate sale of their units. Like shareholders being paid their share of retained income after their shares are cancelled.

Investment account policies - premiums go into policyholders' accounts within a pooled fund. The accounts attract annual bonuses reflecting an annual positive interest rate declared by the life insurer. Account funds are realised on termination of policies. Like bank interest not withdrawn.

Whole-of-life and endowment policies - regular premiums provide specified payouts for risk cover for, say, death and disability **plus** an investment component offering the prospect of 'reversionary' - or permanent - bonuses credited to policyholders regularly and on maturity of the policies. Endowment policies mature prior to policyholders' deaths.

Here are some examples of life insurance investment policies.

The insurers get taxed on their investment income that underpins the policies' bonuses.

They look like regular investment options, though subject to somewhat more control by the life insurers, including no access to assigned bonuses until policy maturity or termination.

I agree, Sami, the investment policies have similarities with regular investments alternatives that people have outside life insurers.

And competitive neutrality says tax investors on them like regular investments, while recognising no early access to assigned bonuses.

Moreover, as with insurer's risk business, the principled way of specifying taxable income from their investment policy business, including its underlying investment activity, is: cash flow plus change in tax values of assets and liabilities - notably deduction for increased policy liabilities.

I like it! How are policyholders treated vis-a-vis their insurers? Policyholders invest funds and are a key source of profit. They are not shareholders or unitholders.

What about the tax treatment of super policies and annuities offered by life insurers?

* Ralph Platform, pp 744-746.

Life insurers' superannuation policies and non-super annuities

We will get further into the tax treatment of holders of life insurers' policies next, Sami. Brad, I will round out life insurers' treatment with that of their superannuation and non-super annuity offerings.

They offer **superannuation policies** with accounts for members just like operators of superannuation funds. Annuities are an investment option within those policies.

The insurers' charge investment management and administration fees on these policies and they pay tax on members' behalf according to the rules applying to contribution, accumulation and pension phases of superannuation.

Life insurers' **annuities** outside superannuation have similarities with their investment policies.
Like investment policyholders, purchasers of annuities pay money to life insurers who invest excess annual funds to cover future annuity payments.

But, as you know, annuities usually involve a single up-front payment to the life insurer followed by immediate payouts, say, monthly or annually. That contrasts the regular premium payments under investment policies followed by potentially long delays before eventual payouts are received.

Regular payouts of annuities may be for a fixed period or until death, may be adjusted for inflation, may allow some repayment of the initial payment, and may have payouts going to someone else on death.

Notably, life insurers are **not taxed on income** that underpins their annuity business so long as income from the annuities is **attributable to annuitants**. The fees charged by insurers for this business are reflected in **shareholder income** and are taxed accordingly, producing shareholder franking credits.

And, Sami, from the perspective of annuitants outside superannuation, the interest component of payouts is assessable.*

Good luck with lifetime annuities on that!

We dealt with the income component of payment streams earlier.*

* Ch5, pp 13-16.

But, Claudia, why isn't the life insurer assessed on the other side of the annuity - like any financial institution providing annuities should be?

That would see life insurers being taxed on underlying income, and getting deductions for the annual interest component, of their annuities - just as banks get deductions for interest attributed to depositors who are then assessed on it.

Good question, Sami. Let me first get back to the tax treatment around life insurers' **investment policies**, which is very different to that for annuities - despite financial similarities.

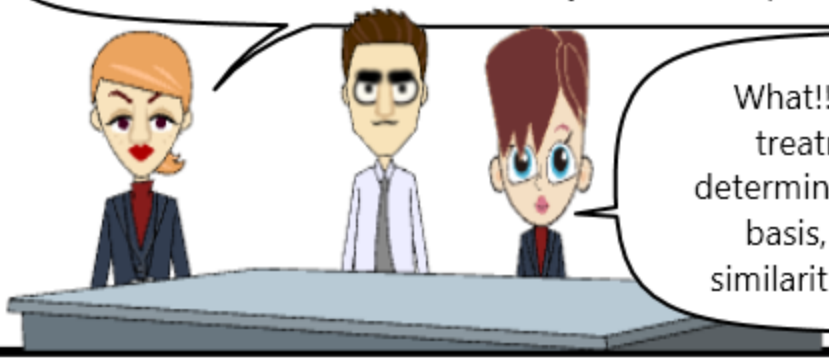
The **insurer is taxed** year by year at the company rate on the income underpinning the **bonuses** eventually received by investment policyholders, and on **shareholder income** from, say, embedded management fees.

Policyholders only pay tax on their policy bonuses with policies that are surrendered or mature within 10 years of commencement, and then at varying rates.

The assessable amount is aggregate bonus payments if received during the first 8 years of a policy, 2/3 of the bonuses if received in the ninth year and 1/3 of bonuses if received in the tenth year.

Direct tax offsets for tax paid by the insurer apply to these bonuses. The offset amount is set at the company tax rate times the taxable bonus amount. Unlike our company imputation system, tax does not apply to the taxable bonus grossed up by the company rate with the full amount of company tax underlying the taxable bonus allowed as a refundable offset.

There are no deductions for losses on investment-linked policies, losses which are most unlikely because of prudential oversight.



What!! Let me see if I understand this treatment which sounds like being determined on a sort of **profit-separation** basis, an approach which does have similarities with the annuities' treatment.

On one hand, those bonuses that are exempt in the hands of policyholders have already been indirectly taxed at the company tax rate, which disadvantages low income people and advantages high income people.

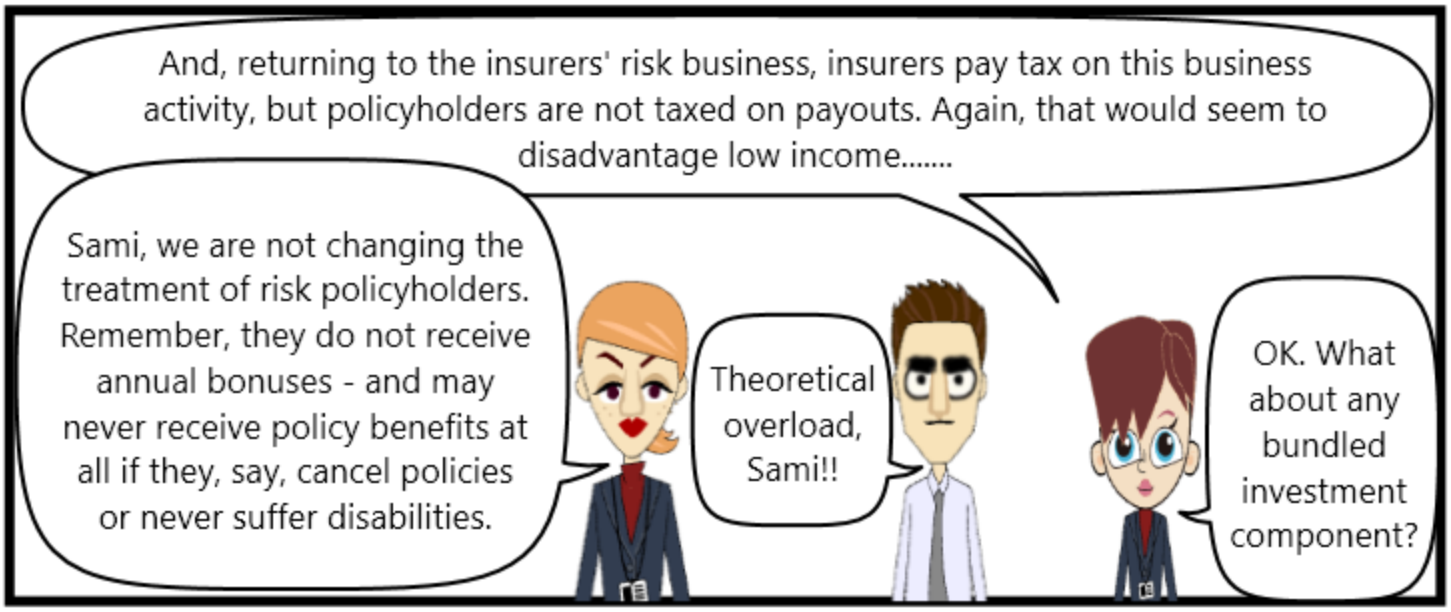
On the other, the life insurer is taxed at the company rate, attracting regular imputation franking credits, on its associated management fees and maybe higher than expected investment earnings.

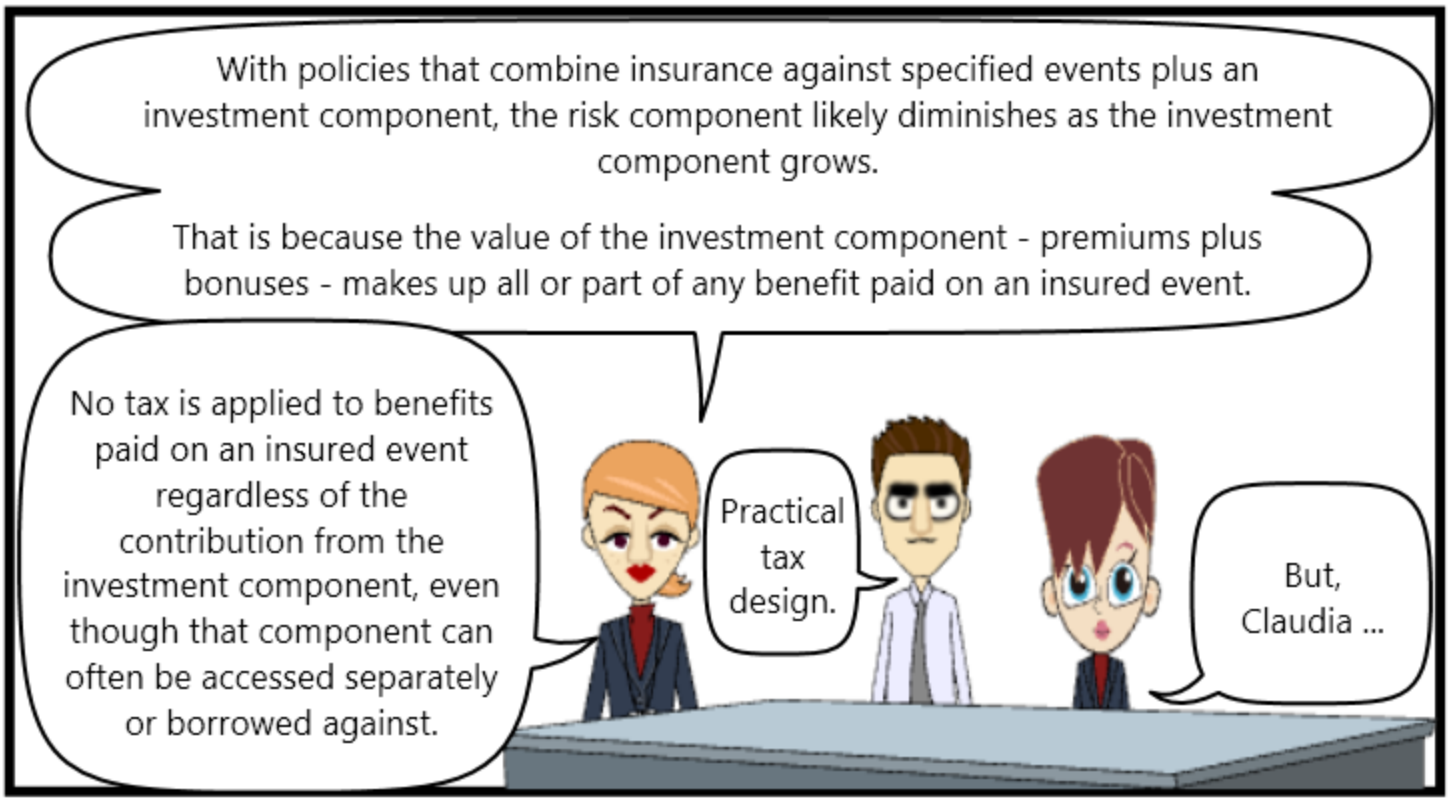
Say, a taxable bonus amount received is $70, reflecting $100 of underlying pre-tax insurer income assuming a 30% tax rate. The policyholder would be taxed on that $70 and receive $21 tax offset, or, 30% times $70.

The policyholder is not taxed on $70 grossed up to $100 with a full $30 offset applied. Consequently, if, say, the policyholder were on a zero tax rate, she would effectively be paying 30% tax on the $100 of insurer income if she could not use any of the $21 offset and 9% if she could.

And, take people on a 50% tax rate. They should pay an extra $20 on the grossed-up $100 of insurer income, bringing their tax on that income to $50. But, under current design, they would only pay an extra $4 after a $21 reduction in their $35 tax on $70 of bonuses.

And, again, the franking credits associated with policyholders' indirectly taxed bonuses, held separately and ultimately paid to policyholders, would be cancelled - ensuring shareholders cannot benefit from them.


And, returning to the insurers' risk business, insurers pay tax on this business activity, but policyholders are not taxed on payouts. Again, that would seem to disadvantage low income.....
Sami, we are not changing the treatment of risk policyholders. Remember, they do not receive annual bonuses - and may never receive policy benefits at all if they, say, cancel policies or never suffer disabilities.
Theoretical overload, Sami!!
OK. What about any bundled investment component?


With policies that combine insurance against specified events plus an investment component, the risk component likely diminishes as the investment component grows.
That is because the value of the investment component - premiums plus bonuses - makes up all or part of any benefit paid on an insured event.
No tax is applied to benefits paid on an insured event regardless of the contribution from the investment component, even though that component can often be accessed separately or borrowed against.
Practical tax design.
But, Claudia ...

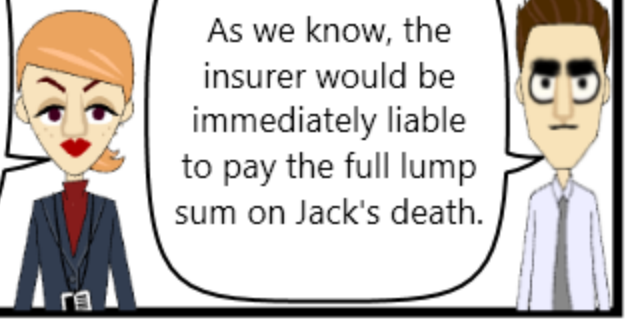

OK, Sami, that will do for now. We will not be proposing to tax the benefits of insurers' risk policies nor investment returns if paid on death or disability. Many less sophisticated investors choose investment policies over, say, mutual funds.
I like your enthusiasm but we do need to keep the differences between investment institutions and insurers in mind.
In fact, an analogy might be instructive using someone choosing a regular financial investment over an insurer's bundled risk and investment policy.
Sam's like a dog with a bone.
Enthusiasm is good, I hope.

Personal direct investment instead of bundled life/investment policy

Imagine Jack wants to leave a specified amount for his family after his death but does not want to waste his premiums if he cancels a pure life policy.

Jack goes along to a life insurer and discusses investment account policies. The insurer checks out Jack's key risk features, like, age, health and lifestyle.

The insurer explains how interest earned would compound under an investment account policy to give him his desired amount when he turns 70 if he paid a set fortnightly amount from his wages as premiums. Because of the benefit of pooling, the insurer also offers that same payout on his death if he paid extra premiums for life cover.



Seeing the extra life cover premiums, Jack decides against the bundled policy.

He reckons he will still be alive at 70 and, by then, would be able to match the payout from the insurer's investment policy by putting his fortnightly amount into an interest-bearing account with a bank - and paying tax each year on his annual interest income at his personal tax rate.

As with the insurer's investment policy, year by year his account balance would increase from the deposits plus compounding interest earned.

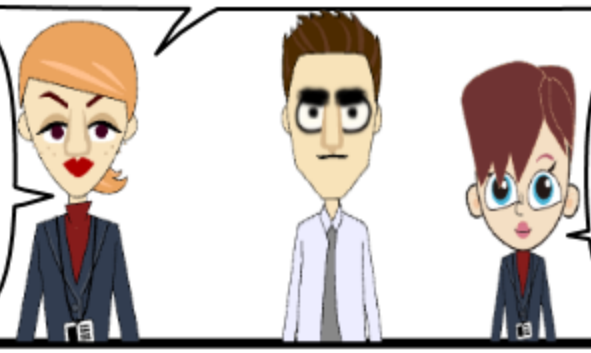
So, for the bank - and for the insurer had Jack taken up the investment account policy - Jack's regular deposits add to taxable income but that is offset by the matching increase in the bank's liability to repay the deposits

Even though the bank's liability to Jack grows from Jack's deposits and compounding interest on them, in net terms, it is just the annual compounding interest that subtracts from the bank's taxable income.

And, the ultimate cash outflow to Jack's estate of the aggregate liability of deposits plus interest will be matched by the bank's associated liability dropping to zero.

Of course, the bank invests Jack's - and other's - deposits in assets to earn income. Naturally, the bank wants this income to more than offset the interest being added to all depositors' accounts.

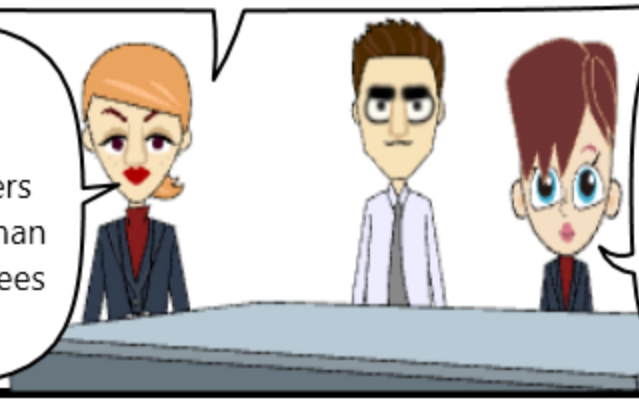
The bank also has to manage the fact that anyone's account could be drawn down at any time



You explained that insurers determine the positive interest rate they apply to their investment account policies year by year.

As with the insurer also, annual taxable income of the bank from its dealings with depositors would simply be cash flows plus annual changes in tax value of assets and liabilities relating both to their deposits and withdrawals and to the bank's investing net deposits.

But, as noted, the insurer would decide whether shareholders or policyholders get returns that are higher than expected - and investment fees also go to shareholders.



Yes - insurer design separates profits between shareholders and investment policyholders.

What's the big deal here? Jack's bank simply gets tax deductions for interest payments to Jack - and Jack gets taxed on his interest receipts.

Imagine if the bank's annual tax savings from its deductions for interest provided matched its annual tax bill from investing net deposits.

Shareholders' angst aside, even though the bank is taxed at the corporate rate, net tax overall would be that paid by depositors on their interest at their personal rates.

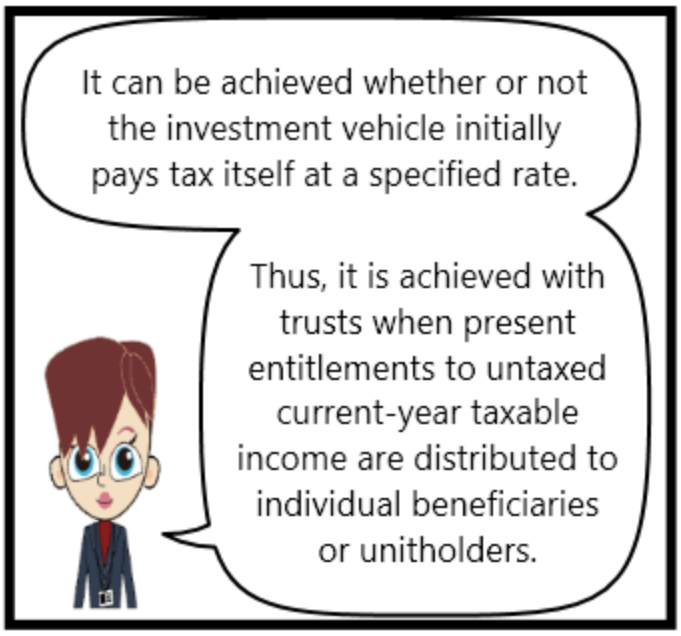
In similar situation with insurers, the same outcome would only arise for investment account policyholders whose tax rate matched the company rate.

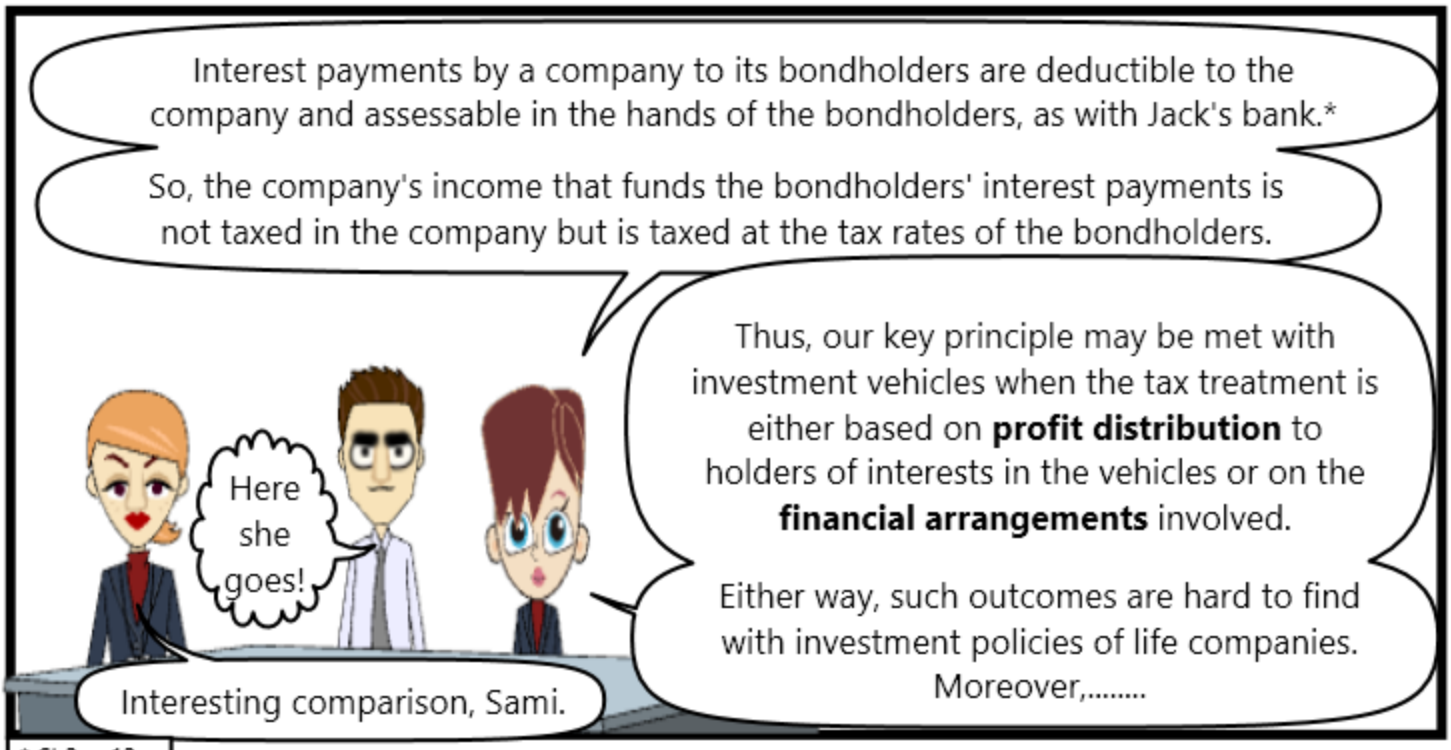
Neat comparison, Sami.

Policyholder tax design: profit distribution or financial arrangements?

Claudia, I thought the regime for taxing life insurers was in good shape when you started off saying that the income from the activities of life insurers is taxed in like manner to income from similar activities elsewhere. And recent changes to life insurers' treatment have been great in that regard.

But now I find the tax treatment of investment policyholders can be way out of kilter with our key overarching principle of having annual investment income taxed at the marginal tax rates of the ultimate individual investor.





* Ch2, p 12.

We worked through many examples of financial arrangements - like, say, leases and rights - where we clarified the income tax treatment of the taxpayers on both sides of the arrangements.*

The taxpayers on both sides were seeking to benefit from the arrangement and the ideal tax treatment met our key principle, regardless of their respective tax rates.

That is the same as the simple case, that I just mentioned, of a business borrowing money.

The lender receives interest income and the borrower uses the borrowing in the hope of funding activities whose profits more than offset the cost of the debt.

The business borrower could be a company, trust or sole trader or Jack's bank.

I'm coming to the view that life insurers' investment policies, including non-super annuities, are better viewed as financial arrangements that require each side of the arrangement to be taxed on a principled basis. But, what do we have?

With **investment policies**, the insurer is taking in money and investing that in the hope of more than covering the bonus payments on the policies. The insurer gets taxed on that investing but associated profits are allocated between investment policyholders and shareholders. And, policyholders are taxed directly or indirectly in a most messy fashion.

With **annuities** outside super, while annuitants are taxed on the interest component of their annuity streams, the insurers are not taxed on the income underlying these streams and naturally get no deductions for the interest component of the payment streams.

In contrast, life insurers' pure **risk business**, with its pooling of risk across all those with life cover, is focused year by year on achieving shareholder profits - with associated taxable income. My chart illustrates that.

Yes, I said we are not proposing to tax risk policy-holders.

Theory over-load, Sami!

Sure, Claudia, but let me show you principled design applied to both sides of annuities and investment policies, including those bundled with life cover - with insurers taxed on associated investment activity.

* Ch5, pp 3-11, 23-28.

Life insurers' investment policies and annuities: possible tax changes

First thing with investment policyholders is not to be tempted to fix their inequitable and inconsistent post-tax outcomes by treating them as shareholders - which they are not - under our imputation system with its refunds of excess imputation credits.

That fix would see policyholders taxed on the annual bonuses allocated to them grossed up for the company tax paid by the insurer on the bonuses with refundable credits provided for company tax paid.*

That would be for bonuses on all policies, both existing and future policies and policies held for more than 10 years.*

Taxing the bonuses each year - with those on low incomes maybe facing no tax - takes away the problem of taxing lump sum benefits paid on insured events.

But - and I see you two are worried - key point is the direct parallel with this design, Claudia, and your integration of company taxable income which is taxed to shareholders each year even when retained.

Consequently, such design change to policyholder bonuses cannot be contemplated **until integration of taxable income is implemented** - and, even then, there is a better way to go, based not on profit-distribution but on financial arrangements involved like those Jack or bondholders have with banks.

INVESTMENT POLICIES

Current treatment - insurer taxed on underlying investment income; policyholders taxed in variable, arbitrary and inequitable fashion on ***bonuses paid*** on maturity or surrender of policies

Possible design change - each year insurer gets annual deduction for increase in liability, and policyholder gets assessed on increase in value, from *accruing bonuses*. Surrender value may be able to be used for life-time/endowment policies**

Rationale - annual increase in accruing bonuses from investment policies are just like increasing value of compounding bank interest, though policyholders cannot access their gains annually

You see, under this alternative, investment policyholders would be directly assessed on their attributed bonuses in their annual returns.

Again, maybe no tax for low-income people.

Here we have Sami at her best, proposing taxing accrued gains again and here on often unsophisticated investors.

Brad, only if similar outcomes apply to all categories of shareholder under integration.

The insurers would be freed from tax on income that funds the bonuses.

* Ralph Platform, Ch 36, pp 735-756.

** Ralph Review, p 508.

ANNUITIES

Current treatment - insurer not assessed on income when it is attributable to annuity policyholders; policyholders assessed on the interest component of payouts purchased with non-super funds

Possible design change - insurers assessed on income underlying annuity payments, thus attracting deductions for the annual interest component of those payments

Rationale - insurers taxed on income underlying annuity payment streams in a way that is consistent with that of providers of similar financial arrangements

Now, with annuities, annuitants are already paying tax on their annual income from insurers' annuities.

But, this change would apply principled design to the insurers' side of the financial arrangement.

To sum up, with these changes, annual taxable income of life insurers would reflect principled treatment on both sides of the **financial arrangements** associated with their investment policies, including non-super annuities.

With their large superannuation businesses kept quite separate, life insurers' other three business activities, as well as, their general investments supporting these businesses, could be assessed in consolidated fashion.

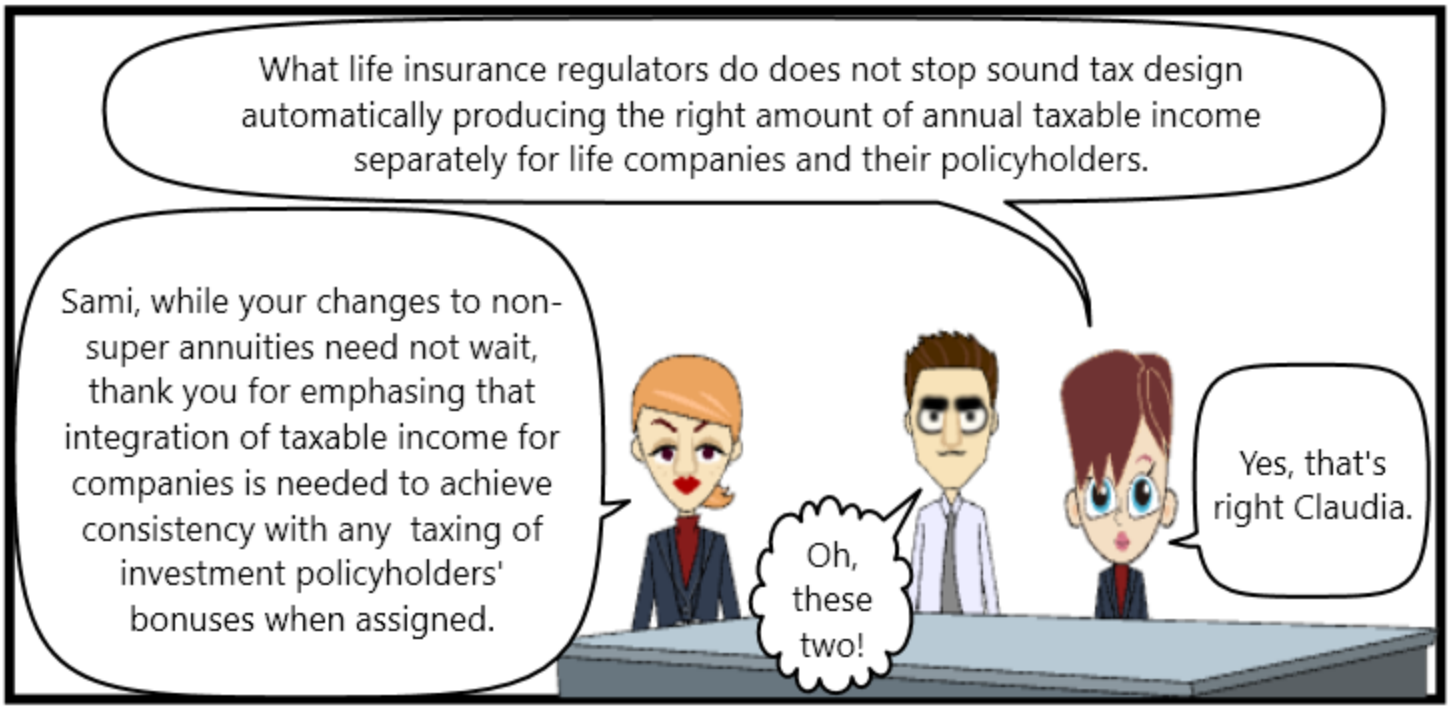
Moving to assess both sides of investment policies and annuities would set the scene for clear simplification and less distortions with taxpayers on both sides of these financial dealings paying tax on their annual income at their marginal tax rates.

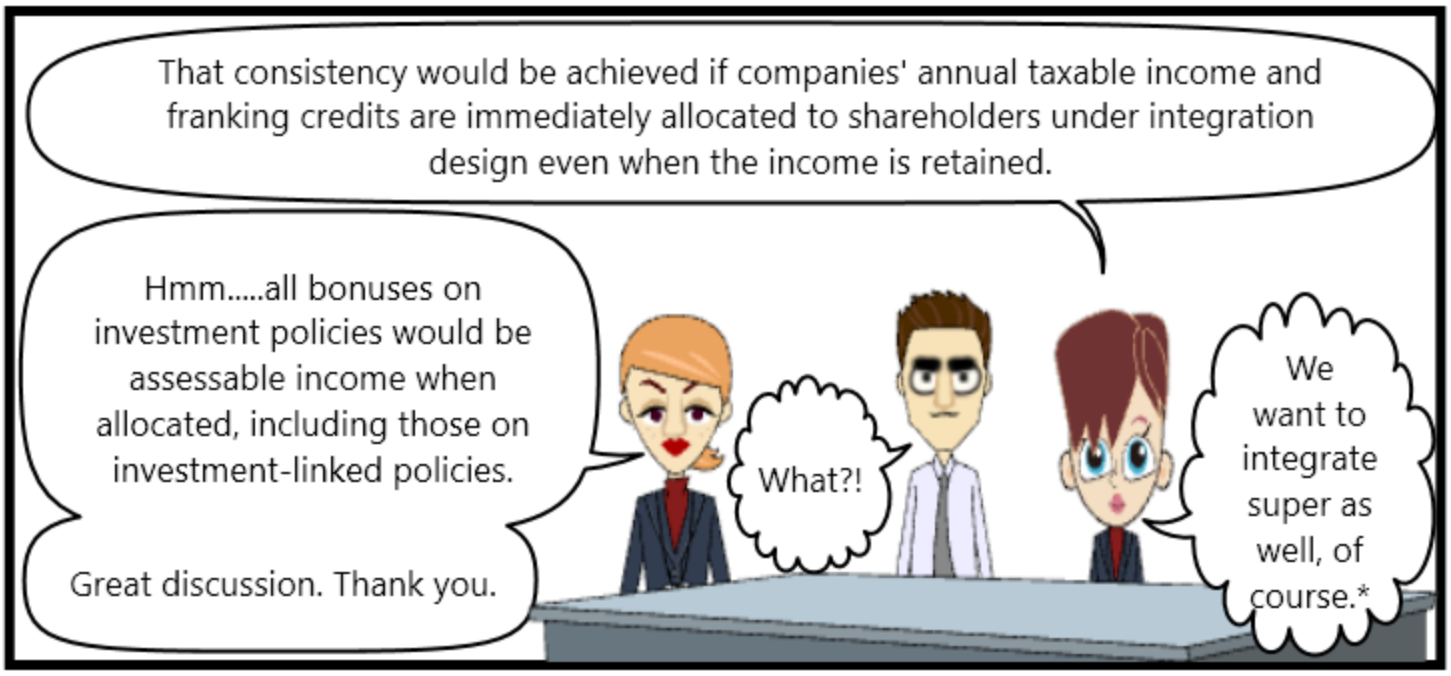
And, with the right amount of tax paid each year by insurers on their non-super activities, life insurers would record the right amount of taxable income and associated credits for distribution to shareholders.

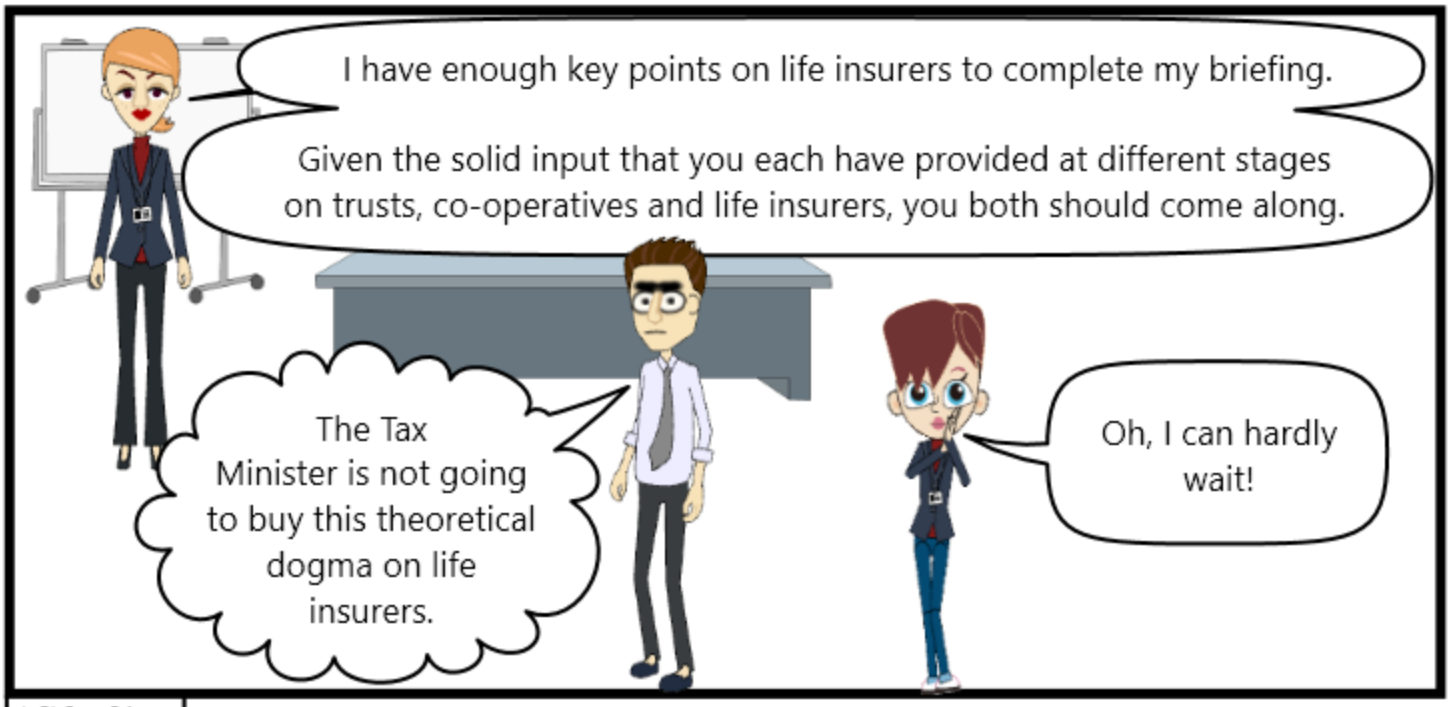
Life insurance regulators would continue to have responsibility to ensure policyholders' delayed payouts are protected.

Time to move from your theoretical fairyland, Sami, and back to the real world.

Oh, c'mon, Brad. I like Sami's analysis, which I will draw from for the briefing for the Tax Minister.


What life insurance regulators do does not stop sound tax design automatically producing the right amount of annual taxable income separately for life companies and their policyholders.
Sami, while your changes to non-super annuities need not wait, thank you for emphasing that integration of taxable income for companies is needed to achieve consistency with any taxing of investment policyholders' bonuses when assigned.
Oh, these two!
Yes, that's right Claudia.


That consistency would be achieved if companies' annual taxable income and franking credits are immediately allocated to shareholders under integration design even when the income is retained.
Hmm.....all bonuses on investment policies would be assessable income when allocated, including those on investment-linked policies.
Great discussion. Thank you.
What?!
We want to integrate super as well, of course.*


I have enough key points on life insurers to complete my briefing.
Given the solid input that you each have provided at different stages on trusts, co-operatives and life insurers, you both should come along.
The Tax Minister is not going to buy this theoretical dogma on life insurers.
Oh, I can hardly wait!

* Ch3, p 31.

Claudia has been working too hard on the Tax Minister's briefing

Thank you for the great briefing, Claudia,

I want legislation drafted up right now for major changes to the taxing of investment income.

The current mass of complex law will be replaced by principle-based design.

The over-arching principle driving the income tax base for investments will be the definition of income as annual cash flow plus annual change in aggregate value of assets and liabilities.

Taxable income will see value of investment assets and liabilities replaced by tax value, set as close as possible to actual value - with reasons for divergence explained.

Integration of taxable income will be the new benchmark for collective investment vehicles, like companies, fixed trusts, co-operatives and superannuation funds. This, plus removal of the CGT discount, will open the way for all holders of life insurers' investment policies being taxed on accruing bonuses, with the insurers getting deductions for matching increased liabilities. Similarly, life insurers' will be assessed on their non-super annuities giving them deductions mirroring the interest income of their annuitants. Thus, life insurers will be readied for integration design, too.

Tax values of international investments will convert annually at spot exchange rates and full tax crediting will apply for both direct and indirect foreign investing.....

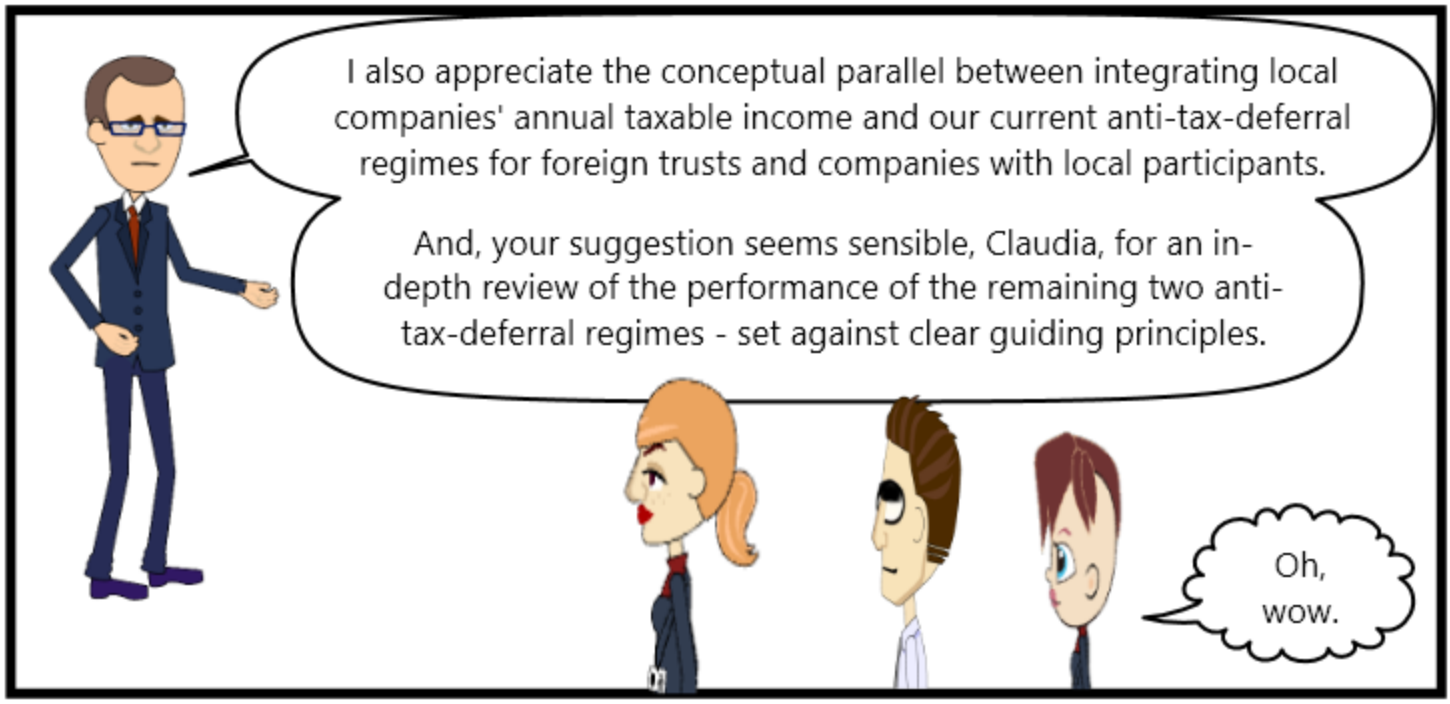
The tax policy team briefs the Tax Minister

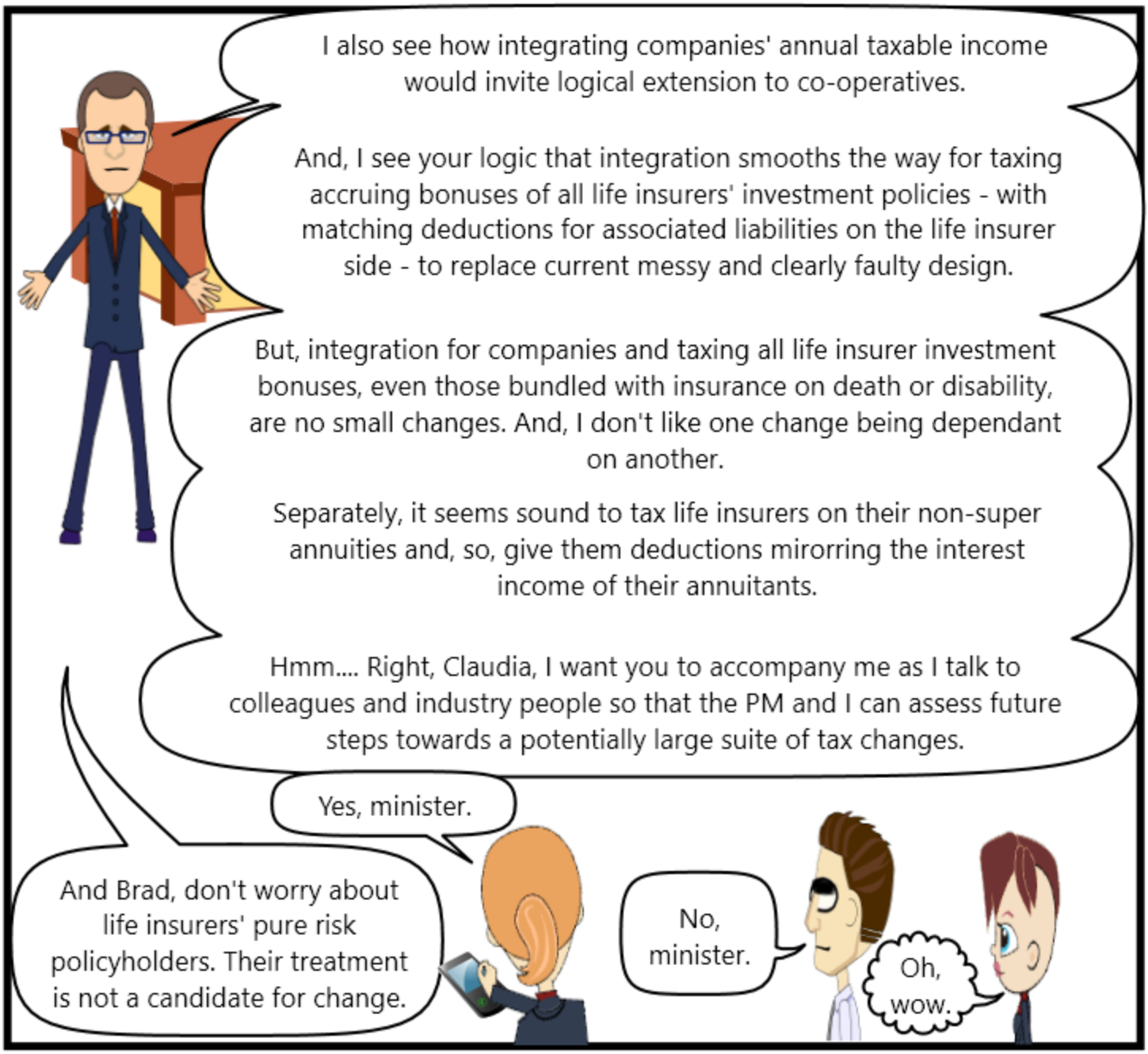
Our discussion has highlighted the inter-related nature of potential changes to company tax design and to the treatment of trusts, co-operatives and life insurers.

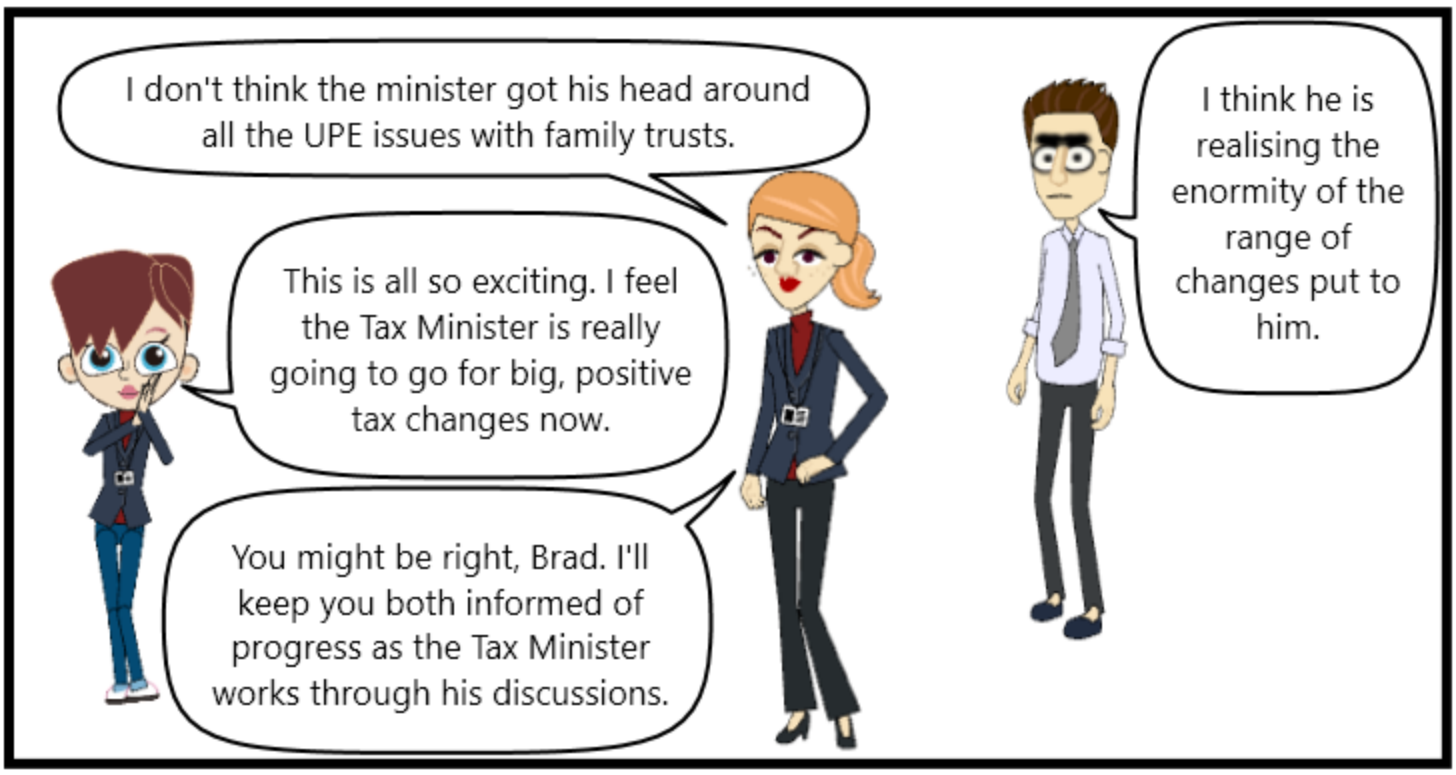
I am reminded of how current treatment of local fixed trusts already fits well with the idea in earlier briefings of integrating local companies' annual taxable income with shareholder tax assessments.

And such integration would address many problems we have with complex company-family trust structures - though specific changes would be needed to deal with problems with family trusts stemming from differences in distributable versus taxable income .

I appreciate, too, the implications of attempting to deal with income splitting amongst family members.




I also see how integrating companies' annual taxable income would invite logical extension to co-operatives.
And, I see your logic that integration smooths the way for taxing accruing bonuses of all life insurers' investment policies - with matching deductions for associated liabilities on the life insurer side - to replace current messy and clearly faulty design.
But, integration for companies and taxing all life insurer investment bonuses, even those bundled with insurance on death or disability, are no small changes. And, I don't like one change being dependant on another.
Separately, it seems sound to tax life insurers on their non-super annuities and, so, give them deductions mirorring the interest income of their annuitants.
Hmm.... Right, Claudia, I want you to accompany me as I talk to colleagues and industry people so that the PM and I can assess future steps towards a potentially large suite of tax changes.
Yes, minister.
And Brad, don't worry about life insurers' pure risk policyholders. Their treatment is not a candidate for change.
No, minister.
Oh, wow.


I don't think the minister got his head around all the UPE issues with family trusts.
This is all so exciting. I feel the Tax Minister is really going to go for big, positive tax changes now.
You might be right, Brad. I'll keep you both informed of progress as the Tax Minister works through his discussions.
I think he is realising the enormity of the range of changes put to him.

Some time later.....

1. Rework the tax code for the investment income tax base across major asset and liability types (including rights and leases) and the CGT system, based on:

(i) annual investment income, comprising cash flow plus change in aggregate tax value of assets and liabilities, being included in all local investors' personal tax assessments in the same year, as far as practicable;

(ii) explanations provided where practicalities require tax values to differ from market value.

2. Consistent with overarching principle in 1(i):

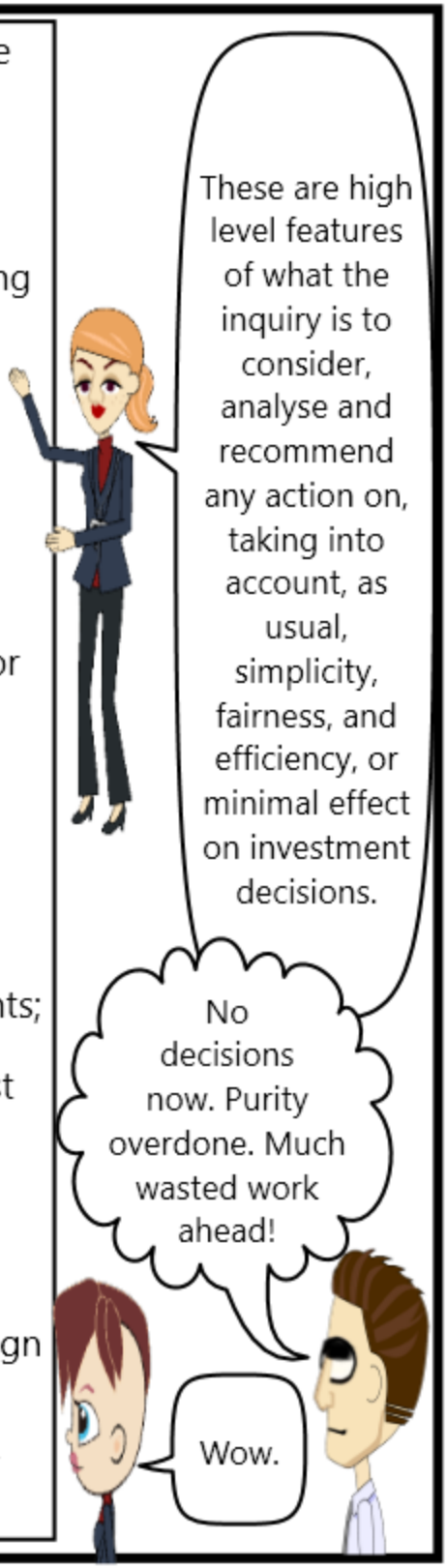
(i) upgrade imputation to integration of taxable income for companies and consider accompanying: **(a)** extension to superannuation funds and co-operatives; and **(b)** tax holders of life insurers' investment policies on all accruing bonuses with insurers getting deductions for matching increased liabilities and tax life insurers' on the income underlying their non-super annuities, giving them deductions reflecting the interest income of their annuitants;

(ii) set distributable income of family trusts as at least trust taxable income less non-cash and non-taxable items and assess scope to address associated income splitting;

(iii) review anti-tax-deferral rules for foreign trusts;

(v) achieve broader and more consistent crediting of foreign taxes;

(vi) review treatment of share buy-backs, consolidation of company groups and CGT on partnerships.



The end of the beginning.....