Department of the
Parliamentary Library

INFORMATION AND RESEARCH SERVICES

Bills Digest

No. 124 2001–02

Taxation Laws Amendment Bill (No. 2) 2002

ISSN 1328-8091

Inquiries

Members, Senators and Parliamentary staff can obtain further information from the Information and Research Services on (02) 6277 2646.

Information and Research Services publications are available on the ParlInfo database.
On the Internet the Department of the Parliamentary Library can be found at:
http://www.aph.gov.au/library/

Published by the Department of the Parliamentary Library, 2002

INFORMATION AND RESEARCH SERVICES

Bills Digest
No. 124 2001–02

Taxation Laws Amendment Bill (No. 2) 2002

Chris Field
Law and Bills Digest Group
6 May 2002

Contents

Taxation Laws Amendment Bill (No. 2) 2002

Date Introduced: 14 March 2002

House: House of Representatives

Portfolio: Treasury

Commencement: The provisions of the Bill have numerous commencement and application dates. The application dates of the various measures described in this Digest are discussed below.

Purpose

To:

- provide for the conversion of franking credits to reflect the 30% company tax rate
- defer the commencement date for certain changes relating to friendly societies
- deny a refund of excess imputation credits for non-complying superannuation funds and approved deposit funds
- implement technical changes to the low income aged persons rebate to clarify who is eligible to receive the rebate, and
- amend the capital gains tax rules so that the demutalisation of Tower Corporation does not cause a capital gains tax event.

Background

As there is no central theme to the Bill the background to the various measures will be discussed below.

Main Provisions

Franking Account

Franking forms part of the dividend imputation system under which resident individuals and certain other institutions, such as superannuation funds, can receive a credit for tax paid by a resident company which pays a dividend. When a resident company pays tax an equivalent amount is credited to its franking account and when dividends are paid there is a debit to the account. Dividends may be unfranked, partly franked or fully franked. In the case of a fully franked dividend the shareholder receives an imputation credit equal to the company tax rate and this can be claimed as a tax rebate or, if there are excess credits (ie credits exceed tax payable) the excess has been refundable since 1 July 2000.

As a result of changing tax rates, companies kept a number of different franking accounts. Prior to 1995-96 companies maintained separate accounts which reflected the company tax rate, class A accounts reflecting the 39% rate, class B reflecting the 33% rate and class C reflecting the 36% rate. Except for a small number of cases, principally life insurance companies, it was required in 1995-96 that all accounts be converted to class C accounts reflecting the current company tax rates. This involved the mathematical conversion of class A and B balances to retain their value relative to the new company tax rate. With the introduction of the 34% tax rate in 2000-01 class C franking accounts were converted to reflect the new rate.

In the Review of Business Taxation (Ralph Report) it was recommended that franking accounts be based on the actual dollar value of tax paid rather than the current system which relies on the company tax rate and the income of the company. Such a change would remove the need for adjustments to franking accounts when the rate of company tax is changed.[1] While it had been anticipated that this change would apply to 2001-02 when the 30% company tax rate was introduced this has not occurred, so that it is necessary to convert the existing class C franking account balances to reflect the new company tax rate.

Schedule 1 of the Bill provides for the conversion of existing franking accounts to the new class C franking accounts. The amendments are of a mathematical nature and deal with the range of franking accounts which can exist in various types of institutions. They all aim to achieve the same result and do not implement any change from previous occasions where there has been such adjustments.

The amendments will apply from 1 July 2001 (**item 11**).

The amendments are the same as those contained in Taxation Laws Amendment Bill (No. 4) 2001 which lapsed when Parliament was prorogued for the 2001 general election.

Friendly Societies

Friendly societies are associations originally established for the relief of members in cases of sickness and to assist surviving spouses and children in the case of the death of a member. Their role expanded in the areas in which members could be assisted to include areas such as life insurance, funeral policies and scholarship plans. Members contribute to the society and their entitlements are based not only on their own contributions but also on the society's earnings on the money held. Over time friendly societies have gone from a tax free basis to having the investment income on certain of their products, particularly life insurance, taxed in the same manner as other institutions offering similar products. Member's contributions remain exempt.

The Ralph Report contained a number of recommendations regarding the taxation of life insurance companies and the life insurance business of friendly societies. While many of the measures were implemented from 1 July 2000, the proposal that policyholders be able to receive imputation credits in respect of certain tax paid by the life insurance company or friendly society was not to operate until 1 July 2001. Part of this process involves determining the capital component of a policy so as to be able to determine the investment earning component, and removing the exemption for friendly societies in respect of earnings on income bonds, funeral policies and scholarship plans to bring their taxation into line with similar products offered by other institutions. In a previously unannounced measure, the explanatory memorandum to the Bill states that due to the need for further consultation with industry the commencement date for the above measures will be extended to 1 July 2002.[2]

Paragraph 320-35(1)(f) of the *Income Tax Assessment Act 1997* (ITAA97) provides that investment income relating to funeral plans, scholarship plans and income bonds issued after 30 November 1999 will cease to be exempt from tax from 1 July 2001. **Item 1 of Schedule 2** will extend the latter date to 1 July 2002.

The amendments are the same as those contained in Taxation Laws Amendment Bill (No. 4) 2001 which lapsed when Parliament was prorogued for the 2001 general election.

Non-complying superannuation funds and Approved Deposit Funds (ADF)

Non-complying superannuation funds and ADFs are, basically, funds and ADFs which do not comply with the rules contained in the *Superannuation Industry (Supervision) Act 1993* and its regulations. Non-complying funds and ADFs receive no taxation concessions and are taxed at the highest marginal tax rate of 47%.

From 1 July 2000 refunds have been available where there are excess imputation credits. As the company tax rate on which imputation credits are based is considerably lower (34% or 30%) than the rate paid by non-complying funds and ADFs, it would appear that non-complying entities would not be able to claim a refund of excess imputation credits. In a recent Press Release the Assistant Treasurer stated:

> However, it might be possible for such funds to enter into artificial schemes so as to produce surplus imputation credits.[3]

The Assistant Treasurer then announced that amendments would be made to deny refunds to non-complying funds and ADFs and that this was in line with the policy of providing 'tax concessions only for complying superannuation entities, where prudential controls provide some certainty that the concession will generate retirement income for individual fund members'.[4] It was also announced that the amendments would apply to the financial year of an entity containing the date of announcement (22 May 2001), thus for most entities which end their financial year on 30 June the changes will apply from 1 July 2000.

Item 6 of Schedule 4 will amend sub-section 67-25(1) of the ITAA97, which deals with the entities eligible to receive a refund, to specifically exclude non-complying superannuation funds and ADFs.

Application: For income years ending on or after 22 May 2001 (**item 8**).

The amendments are the same as those contained in Taxation Laws Amendment Bill (No. 4) 2001 which lapsed when Parliament was prorogued for the 2001 general election.

Low Income Aged Persons Rebate

This rebate, also known as the seniors rebate, is available to people who:

- are in receipt of a pension, allowance or other benefit under the *Veterans' Entitlements Act 1986* and have reached pension age under that Act (for 2000-01 this is 60 years for males and 57 for females – the later age is being increased by increments to 60), or

- have reached pension age under the *Social Security Act 1991* (for 2000-01 65 for males and 62 for females – again the later age is being increased to 65), have 10 years qualifying Australian residence or a residence exemption and are not in goal, and

- satisfy the income requirements.

For eligible single people in 2000-01 the maximum rebate available was $2230 for taxable income of $20 000 or less and the rebate decreases by 12.5 cents for each dollar in income above this amount, so that the rebate ceases to be available when income reaches $37 840. The income amounts are indexed for later years.

For a member of a couple, the maximum rebate for 2000-01 was $1602 for income of $16 306 or less (each member of a couple is deemed to earn half of their combined income when determining eligibility for the rebate, although actual taxable income is used in determining the amount of the rebate). For incomes above this amount the rebate again decreases by 12.5 cents in the dollar with the rebate ceasing to be available when income reaches $35 202.

On 8 April 2002 the Australian Taxation Office (ATO) announced that it had reviewed returns for people who may be eligible for the rebate in 2000-01 and found that while approximately 170 000 people correctly claimed the rebate, many had not. The review found that:

- about 57 000 who had not claimed the rebate were eligible and that the ATO had enough information to assess the amount payable to these people
- approximately 2000 people were wrongly denied the rebate due to a 'processing error'. These peoples entitlements would also be assessed automatically, and
- approximately 13 000 additional people may be eligible for the rebate but the ATO lacks sufficient information to assess eligibility. More information would be requested in regard to these people.

It was estimated that approximately $60 million would be paid to the 59 000 people assessed as eligible for the rebate.[5]

As noted above, one of the criteria for eligibility for the rebate is the receipt of a pension, allowance or benefit under the *Veterans' Entitlements Act 1986,* compared to eligibility to receive a pension under the *Social Security Act 1991*. Amendments contained in **Schedule 6** of the Bill will remove this difference so that those eligible, but not in receipt of, a veterans pension, benefit or other allowance will also be able to receive the rebate.

Application: For the 2000-01 and later income years (**item 3 of Schedule 6**).

Tower Corporation

Tower Corporation had its origins in the New Zealand Government Life Insurance Office which was established by an Act of Parliament in 1869. This body was corporatised in 1983 and from 1 October 1989 the life insurance body and its subsidiaries became know as Tower Corporation. From July 1990 Tower Corporation became owned by the policyholders rather than the government and legislation also provided for Tower to be converted into a limited liability corporation listed on the stock exchange.

Since 1990 Tower has expanded its operations from life insurance and now operates general insurance and financial and investment management in New Zealand, Australia, China and the South Pacific, although not all of these services are provided in Australia. Tower was demutualised on 1 October 1999 with shares in the new entity being distributed to policy holders and listed on the stock exchange in New Zealand and Australia.

There are provisions in the ITAA36 and ITAA97 to protect taxpayers from possible taxation consequences of demutualisation, principally to prevent a capital gain from arising on the surrender of the mutual interest and the acquisition of shares. The calculation of the cost base for capital gains tax (CGT) purposes for any subsequent disposal of the shares is also dealt with. For Australian life and general insurance organisations these rules apply from 9 May 1995, while for other Australian organisations the rules apply from 12 May 1998. On 23 September 1999 the Assistant Treasurer announced that similar rules would apply to the demutualisation of non-resident mutual companies which have an Australian subsidiary. The announcement specifically stated that the move would address the position of Tower Corporation.[6]

Item 2 of Schedule 7 of the Bill will insert new subdivision 118-H into the ITAA97 dealing with the CGT implications of the demutualisation of Tower Corporation. **Proposed section 118-550** provides that no capital gain or loss will arise from membership rights in Tower Corporation ceasing to exist and that the cost base for any shares acquired will not include any amount paid to acquire the membership rights in Tower Corporation.

Application: To all income years (**item 3 of Schedule 7**).

Endnotes

1 Review of Business Taxation, p. 419.

2 *Explanatory Memorandum*, p. 23.

3 Assistant Treasurer, *Press Release*, 22 May 2001.

4 ibid.

5 Australian Taxation Office, *Media Release* 02/20, 8 April 2002.

6 Assistant Treasurer, *Press Release*, 23 September 1999.