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28 August 2008

Tax Law Amendment (2008 Measure No.4) Bill 2008

Second Reading

Mr BRADBURY (Lindsay) (10.08 a.m.) — I am very pleased to rise in support of the Tax Laws Amendment (2008 Measures No. 4) Bill 2008. In particular, I would like to comment on schedules 1 and 2 of the bill. I note that the amendments proposed in schedule 3 of the bill are largely of a technical nature. They are not so much substantive but directed towards correcting some minor drafting difficulties that have existed in the past.

Schedule 1 is a significant proposal that will affect many people throughout our community. I should in the interests of full disclosure acknowledge that my wife and I are policyholders with the MBF, which is obviously one of those entities that would be affected by the proposals currently before the House. In relation to demutualisation, the mutuality principle is a very well-known concept in the taxation context. Those members or participants in a mutual fund contribute to the fund and continue to retain an interest in the funds of the fund. Ultimately, where there is a decision taken by the common fund to divest the accumulated surplus of that fund, that is the process that we describe as demutualisation. Essentially, the interests, the rights and entitlements, that each of those individuals or entities have in the common fund are surrendered and, as a result of that, there is a distribution of the surplus funds contained within the fund.

In the absence of any statutory provision to provide relief from capital gains tax, capital gains tax would ordinarily apply in respect of those distributions. I think it would be accepted that the notion of distributing funds back to the policyholders is by its nature a CGT event and triggers a taxation liability, whether that be in the form of a gain or a loss. These proposals are directed towards ensuring that those policyholders, those participants in the health insurance sphere, when a surplus is distributed as a result of demutualisation, will have any gains or losses from a capital gains tax perspective disregarded. This is not an uncommon treatment of this type of arrangement. If we look at it in the context of other insurers, general insurers and life insurers, for example, there is clearly a precedent for this type of treatment. This bill merely seeks to clarify the position in relation to private health insurance, which, in the context of what has occurred in the past with NIB and, more recently, MBF, is of real concern and real interest to many policyholders who are expecting to receive some of that distributed surplus but may be uncertain as to the taxation implications of those events. So it is important from that perspective—it is critical, in fact—that this parliament passes this legislation, to give certainty to policyholders so that they can be clear on what their taxation obligations are in respect of that demutualisation and all other demutualisations that occur in this context into the future.

In relation to the treatment of any shares issued or any rights granted as a result of the demutualisation process, these proposals will ensure that those shares or rights, those interests, will be passed back into the hands of the individual or entity. But, for capital gains tax purposes, those interests will have a deemed market value as their cost base, which will ultimately be of significance for those individuals that

later dispose of those interests and trigger a subsequent tax liability. There will be greater certainty about the quantum of that liability because through this proposal we are clarifying what the cost base is.

There is one further aspect of schedule 1 that I wish to comment on, in relation to ensuring that, in the case of a policyholder dying during the demutualisation process, the tax treatment of any interests that they are entitled to are passed on and similar tax treatment is provided to the executor or beneficiaries of their estate. That might seem like an unusual set of circumstances, but, considering the large number of policyholders of some of these mutuals, throughout that process—which can sometimes take some time—there will no doubt be cases where people fall into those categories. I certainly commend the bill and schedule 1 in respect of those changes.

In respect of the much vexed schedule 2, as previous speakers have indicated, it has been the subject of much discussion in the Senate and by the Senate Economics Committee's report on this bill. To briefly outline the significance of the proposals, the amendments before us address the essential concern that the current definition of 'family' and the ability of family trusts to make a one-off variation to the 'test individual' specified in a family trust election—'test individual' being a concept set out in the legislation—provide more scope for family trusts to transfer the benefits of tax losses to future generations to lower their income tax. These amendments seek to change the definition of 'family' in the family trust election rules to limit lineal descendants to children or grandchildren of the test individual or of the test individual's spouse. There was much discussion before the Senate committee about what ultimately the revenue impact or the savings impact of this might be.

As to the significance of this, I think one would be somewhat misinformed to approach this simply from a revenue perspective, because essentially there is a common-sense test that needs to be applied here. I think that what we are talking about, in the context of these rules, is where losses have been generated by an individual or by an entity. A fairly fundamental principle of taxation law is that, as to the benefit of losses—and losses do carry a benefit in taxation terms because they can be used to offset gains—where losses are incurred by an individual or an entity then that individual or entity has some ownership over those losses. It is not unreasonable for that individual or that entity to get the benefit of those losses to be offset against other income.

But it is a different proposition to start providing for transfers of those losses to others that might not have borne the real economic loss. Where that is done we start to get into some of the avoidance issues that emerge right across the tax system. That is why at the company level we clearly have rules in place—for example, the continuity of ownership test and the same business test—to ensure that there is not trafficking of losses, that individuals or entities that did not bear the economic cost of the losses are not the beneficiaries of those losses. In a sense this is, at a theoretical level, the argument that should have occurred before the Senate committee, but unfortunately there was what I think was a disproportionate focus on the revenue aspects. I want to go through and look at a couple of the comments made. In fact, I want to refer to one of the comments that was made in the dissenting committee report by coalition senators. It is on page 11: The current moves against changes to family trusts have little to do with closing loop holes and are far more, it appears,—to do with—a move to transition trusts to entity taxation laws.

I will come back to entity taxation laws a little bit later. I will move on and look at some extracts from the transcript of the committee hearing. In particular I am interested in this following extract where Senator Bushby said:

For every extra that you earn over a certain point, you will still be paying the top individual tax rate.

Then Mr Noroozi of the Institute of Chartered Accountants in Australia replied:

I am happy to answer that question. Can I just make one point first: there may be some question over the way trusts are taxed at the moment; should the trust laws and the taxing of them be the way they are? I do not think that is a question for this committee on this legislation at the moment. That question was addressed. There was some talk some years ago as to whether trusts should be taxed like companies and the board of tax addressed that issue. There was long-term discussion—

And then Senator Bushby says:

I do not want to raise that as an issue.

I can understand why he would not want to raise that as an issue even though it came up in the context of the comments that were originally made by Senator Bushby. But I think it shines a little bit of light on what used to be the policy of the former government, for various parts of their time in government, on the vexed issue of entity taxation, which we all know was one of the subjects of the very strong recommendations of the review of business taxation, the Ralph review. In fact, the then Treasurer, the member for Higgins, indicated at the time that the government was prepared to adopt the recommendations of the Ralph review. We then had the situation where clearly there was a bit of strong-arming going on, particularly by the National Party. We hear all these stories about the 'once-mighty' member for Higgins and how the emerging economic contagion that confronts the world economy can only be confronted by bringing back and drafting the 'once-great' Treasurer. You would think that, in the face of not much more than a few whimpers at the time from the National Party, that the 'once-great' Treasurer would have been able to withstand the blowtorch of the likes of the National Party. But, unfortunately, as the historic record shows, he was not able to do that.

We saw what I think is one of the most ignominious examples of a minister, in particular a Treasurer, backing down on a policy that he had committed his government to. On 11 November 1999, the then Treasurer distanced himself from entity taxation, and that was after having previously adopted the recommendations of the Ralph review. I am most interested to note his justification for walking away from entity taxation. Clearly, as we all know, behind the scenes there was the great threat that the National Party posed. Let us look at what reasons were ostensibly offered up at the time by the then Treasurer. He said:

As outlined in the Government's 21 September announcement on business taxation reform, the consistent tax treatment of trusts and companies will commence from 1 July 2001 . The commencement of entity taxation was deferred—to begin with it was deferred; the decision was not taken to can it straightaway— in recognition of the current demand on business associated with the need to address Y2K compliance needs—There was a lot of hysteria in the lead-up to the so-called arrival of the millennium bug. We all know thata lot of efforts went into preparing for that, but it really fizzled out. It seems to me that the lasting legacy of the threat posed by the Y2K bug was that it hammered the final nail in the coffin of entity taxation. The once great former Treasurer was brought to his knees by the Y2K bug, and that was the end of entity taxation. It seems that it also signalled, once again, the dominance of the National Party in driving economic policy within the former coalition government. It is a sad record. I am not surprised that Senator Bushby did not want to go any further down that line of questioning, but it is one that inevitably emerges in discussion of the current position of the opposition in relation to this set of measures.

There is one final extract from the discussion that I wish to refer to. I think this is relevant for a few reasons. This is also in an exchange between Senator Bushby and Mr Noroozi. Senator Bushby says:

… You mentioned earlier that one of the advantages of the legislation that was passed last year was that it made it easier for small businesses to carry forward losses and to deal with those in an appropriate manner, but you suggested that there were a number of hoops that they would have to go through if that legislation had not been passed.

Mr Noroozi—*I am sorry; I may have misled you. I was saying that, for trusts generally to utilise their losses—forget family trusts for a minute; just trusts generally—there are a number of hoops they have to go through. The rationale is that the underlying individuals or whoever, taxpayers, who incurred the loss should be able to also recoup it—the same individuals. However, with family trusts, because you know that the beneficiaries are usually members of the same family, there is a presumption that the same people that incurred the loss will also be—this is putting it very simply and perhaps not accurately.* Basically with election to be a family trust—And he goes on. *The essential point that he is making there is the point I was making earlier. Where a loss is incurred, the value of that loss should only be available to the individual or the entity that incurred the true economic cost of that loss.*

The amendments that were introduced that brought about this situation extended the scope of the definition of family and brought individuals such as the lineal descendants of nephews into the picture. There may be some families where there is an argument that a nephew's descendant is so inextricably linked into the economic unit of the uncle or the aunty that they should legitimately be able to obtain the benefit of the loss—because in some way they incurred the economic cost—but I would think that that would be an absolute and very small minority of cases. That is what we are talking about here. It is a perversion of one of the most fundamental principles of our taxation system, and that is that losses should only be available to be utilised by those that incurred the economic cost.

Those on the other side who want to lecture those of us in the government about economic management, about economic purity, should have a good hard look at themselves, because, frankly, in going down the populist path that they are going down, pandering to the National Party, they are simply surrendering the last vestiges of the credibility that they once had. They do not have a lot of credibility on this issue. The member for Higgins and his dismal performance in relation to entity taxation is a perfect example of where, when it comes to confronting real economic reform in this country, vested interests—more often than not the National Party—unfortunately get in the way.

I want to quote from a Financial Review editorial. I note that the Financial Review do not always agree with things that I say, but on this occasion I agree with something that they said back on Friday, 8 December 2000. The heading to this editorial was 'Tax reform left in the lurch'. The comment that begins the editorial is salient:

The failure to push the Federal Government's new tax treatment for trusts through Parliament this week represents another blow to the once ambitious business tax reform agenda that promised "a new tax system" rather than just a new tax.

With the benefit of hindsight, we all know that the charade that was the review of business taxation and the charade that was the new tax system were about one thing alone—delivering a new tax.

Those on the other side have surrendered their reform credentials and their economic credentials. If they are prepared once again to succumb to vested interests, not to support an election commitment of this government and to do what they have done on so many other fronts—to block significant revenue measures that will produce a significant part of our budget surplus—then once again they are demonstrating that they have lost touch with the central economic challenge facing this country. I commend the bill to the House.