



Investment & Financial Services Association Ltd
ACN 080 744 163

18 January 2008

The Hon. Wayne Swan MP
Treasurer
Parliament House
CANBERRA ACT 2600

Dear Treasurer

IFSA PRE-BUDGET SUBMISSION

Thank you for your invitation for submissions to assist in the formulation of the 2008 Budget.

The **Investment and Financial Services Association Limited (IFSA)**, is a national not for profit organisation which represents the retail and wholesale funds management, superannuation and life insurance industries. IFSA has over 140 members who are responsible for investing over \$1 trillion on behalf of more than ten million Australians. Members' compliance with IFSA Standards and Guidance Notes ensures the promotion of industry best practice.

IFSA commends and supports the Government's foresight in promoting the potential of the financial services industry. The global economic dynamics are changing daily, and IFSA believes that the financial services industry is unique in representing the enterprise culture that will secure and drive Australia's economic growth. With \$1 trillion under management, the industry is as passionate about growing Australia's long-term savings, as it is about ensuring we are an attractive investment destination for offshore capital.

As such, we make the following recommendations based on both ensuring the adequacy and protection of Australia's national savings, and the overall efficiency of the industry. We believe that a Government announcement on any number of these issues would significantly contribute to the growth and development of the industry.

We look forward to working with you as you implement your election policies. In particular, we note your support for the Managed Investment Tax Regime (MITR) proposal, and in this regard we record our thanks.

AUSTRALIA AS A GLOBAL FINANCIAL SERVICES CENTRE

Investment Manager Exemption

One of the fundamental tenets of our income taxation system is that non-residents should not be subject to Australian tax on foreign income and gains. However, the funds management industry continues to encounter difficulty in exporting its services due to the inadvertent application of withholding taxes to profits and gains from foreign sources which are treated as Australian source income under Australian tax law.

Examples of such inadvertent application can be found in the rules for the taxation of foreign exchange gains, bond profits and the taxing of hedge funds due to Australian management & control of the managed fund. In addition, Australian tax can apply to a non-resident's share of income attributed under the Controlling Foreign Company (CFC) and Foreign Investment Fund (FIF) attribution rules due to an ATO interpretation of Australian tax law.

The United Kingdom has an 'investment management exemption' which allows a manager acting for a non-resident to be exempt from assessment on behalf of its non-resident client, including offshore funds. The exemption was introduced to encourage non-residents to invest through British institutions. Hong Kong has recently announced that it will be enacting an investment manager exemption akin to that in the United Kingdom.

A similar exemption could be used in Australia, to address situations in which foreign source income flowing through to non-residents is taken to be Australian source income under Australian tax law because the management and control function is performed by an Australian fund manager. So doing would provide a significant boost to the export activities of the funds management industry.

Fees derived by Australian fund managers from this activity would be subject to tax at the normal corporate tax rate.

Board of Taxation's Review of Australia's anti-deferral regimes

IFSA strongly supports the Board of Taxation's Review into Australia's anti-deferral regimes and believes it is a key initiative in addressing inefficiencies in Australia's current international tax regime.

The current operation of both the Controlling Foreign Company (CFC) and Foreign Investment Fund (FIF) regimes places a large compliance burden on Australian fund managers, and artificially limits their ability to take advantage of emerging trends in the global market.

Reform of these rules will greatly assist in making Australia a global financial services centre, and IFSA looks forward to the release of the Board's report in due course.

Withholding tax on distributions to non-residents from Australian managed funds

IFSA supports the Government's intention to introduce a flat and final 15% withholding tax rate on distributions from managed funds to 15%. IFSA believes that it is critical that non-resident investors consider the Australian withholding tax system is competitive with the other countries in the world, particularly those within our region, and that the current rate of 30% is a disincentive for non-residents to invest in Australia.

We note that our preferred approach is the introduction of a flat and final rate of 12.5%, given the withholding tax rates of our competitors in the region: Japan has a Real Estate Investment Trust (REIT) withholding tax rate of 7% (increasing to 15% from April 2009), at present Singapore imposes 0% for individuals and 10% for other investors, and Hong Kong has an effective rate of 15% on REITs.

Nonetheless, we look forward to working with the Government and Treasury in implementing the new withholding tax regime.

Collection of Data on Australia as a Global Financial Services Centre

IFSA supports additional specific purpose funding for the Australian Bureau of Statistics (ABS) to significantly improve the quality of data collected and published on funds management cross-border flows. This funding would benefit public policy decision making in

areas such as Free Trade Agreement and Double-Tax Agreement negotiations as well as regulatory mutual recognition discussions.

At present, the only official data available on managed funds is that provided in the ABS Catalogue 5655.0 Managed Funds, Australia.

In respect of cross-border capital flows, this catalogue uses aggregated categories titled 'funds from overseas' and 'assets overseas' for total assets derived from overseas sources and total assets held overseas respectively.

This aggregation leads to the following gaps:

- The data does not capture *flows*, rather just the total *stock* at a given point in time, making it more difficult to assess trends in cross-border fund movements.
- The Catalogue does not currently provide details on the asset classes into which these funds are invested (either domestically or overseas). For example, there is no breakdown of either flows or the stock of funds according to: equities, real-estate investment trusts (or LPTs), fixed interest, private equity, alternative assets, etc.
- In relation to the aggregate 'funds from overseas' and 'assets overseas', neither the country source nor country destination is currently disclosed. This information would be particularly useful in assessing the success of government initiatives to facilitate Australia's export of financial services across different markets. More specifically, it would allow vital information on funds flows to be utilised for the benefit of negotiations around mutual recognition agreements between country regulators, free trade agreements and even double tax agreements.
- Further transparency with respect to the form of the cross-border flows would also be desirable beyond merely "direct" and "indirect" classifications. This would provide a more in-depth understanding of the investment vehicles being used by foreign investors investing in the Australian market and vice-versa.

In addition to improving the quantity and quality of funds management data, the ABS could partner with industry in producing a related data series designed to measure the value of funds management exports.

This would data series would ideally take account of the "cluster of services" that necessarily attaches to the provision of any funds management service.

Specifically, this "cluster of services" includes: Asset management; Investment consulting; Platform delivery systems; wrap accounts and master trusts; Custodial and registry services; Financial service IT and software; development providers; Actuarial services; Legal and accounting services; Compliance and risk monitoring; Investment performance research and reporting; Education and training services; Portfolio administration services; as well as Advice/distribution.

While the ABS does currently measure 'exports of financial services' in catalogue 5368.0 International Trade in Services and associated sub-catalogues, it does not take account of the value of these attaching financial services.

IFSA notes that private sector research houses have questioned the ABS' calculations in terms of total funds under management as well as the proportion of funds sourced from off-shore. IFSA would be pleased to arrange a series of industry roundtables with such research houses and the ABS, Treasury and other relevant stakeholders to contribute towards the development of more detailed and robust data on our industry.

BUILDING NATIONAL SAVINGS AND ENSURING FINANCIAL SECURITY

Extend the tax deductibility of personal contributions in super

IFSA supports the general principle of extending the deductibility of personal contributions to all individuals, regardless of whether they are an employee or an unsupported person (such as someone who is self-employed), by removing the 10% threshold.

We believe that such an initiative will not only help to build the superannuation savings of Australian workers, but also substantially reduce the complexity of the current rules in relation to eligibility to make personal deductible contributions. In addition, it will remove inequity between employees who have the ability to make salary sacrifice contributions and those who do not.

IFSA recommends that the measure can be integrated with the co-contribution regime in a way that recognises revenue costs and delivers equity across individuals of different income levels. The existing concessional contribution cap will naturally limit the amount of contributions and deter abuse of the deduction by taxing excessive contributions at the highest marginal rate.

We recognise that there needs to be sufficient time to ensure that the design and implementation of the measure is sound, which could delay its operation until 2009/10.

Tax treatment of death benefits paid by employers

IFSA is concerned with the different tax treatment that applies to death benefits paid by an employer compared to equivalent benefits paid via a superannuation fund or directly from a life insurance company to beneficiaries.

Under the current law, death benefits paid by an employer are subject to a \$140,000 cap, with amounts over this threshold taxed at highest marginal tax rate (plus Medicare levy). In contrast, benefits paid to a dependant from a super fund, are tax free.

Following the introduction of the *Superannuation Legislation Amendment (Choice of Superannuation Fund) Act 2004* ('Choice of Fund') legislation from 1 July 2005 it is no longer the case that employees of an employer all belong to a single superannuation fund. This being the case, employers cannot simply restructure the cover via the 'default fund' as this will not necessarily capture all employees.

Furthermore, the legislation provided an exemption that allowed (and to a certain extent, actually encouraged) employers to arrange cover outside superannuation, and still meet the obligations imposed by the Act. The industry saw this as a very important concession as it allowed employers to provide cover under blanket group risk insurance contracts for all employees, irrespective of whether or not an individual employee had exercised Choice of Fund, yet still met the purpose of the legislation.

This exemption assists in providing cover where the employee would otherwise not have access to it, and in addition, removes the moral risk faced by employers where a member who exercises Choice of Fund is left uninsured. Having recognised in legislation the need for this type of cover to be provided, it would now appear counterintuitive to impose punitive tax rates on such arrangements.

By way of background, while group insurance arrangements have been around for a number of years, they are still in their infancy when viewed in light of the substantial structural changes the industry has undergone since the 1970's.

Group arrangers, particularly employers, are an important means of reducing underinsurance as they begin to see the value in life insurance as a means of attracting and retaining staff.

The benefits of these arrangements are more generous underwriting terms, reduced premium rates and enhanced terms and conditions compared to standard insurance policies.

We understand that there is a policy intention to separate employment termination payments from superannuation payments under the 'Simple Super' reforms (which removed the 'eligible termination payment' concept from tax law), and appreciate that there is significant merit in separating the two types of payment. However, we do not consider that the disparity in tax treatment between death benefits paid via the different regimes is an intended outcome of that process. As a matter of good tax policy we consider it appropriate that like-transactions attract similar tax treatment. For example, if an employer routinely pays the dependents of deceased employees and amount equal to three times annual salary, this would be subject to tax under the new regime. An identical payment from a superannuation fund would not.

It has been suggested that the problems could be overcome by restructuring insurance arrangements such that the cover is provided via a superannuation arrangement rather than via the employment relationship. Unfortunately in many cases this cannot easily be achieved.

For these reasons we request that the legislative provisions be amended to bring greater parity between the tax treatment of insurance cover arranged via an employer and cover arranged via alternative structures. We believe that in the case of death benefit payments, the cap should increase to \$500,000, in order to address the disparate tax treatment.

Taxation of Temporary and Permanent Disability (TPD) benefits

A disability benefit is a lump sum benefit provided by a superannuation fund to a member who suffers permanent incapacity as envisaged by the superannuation regulations.

The tax free portion of a disability benefit is calculated by reference to a formula based on the member's service days and days to retirement. The balance of the payment is taxed as a lump sum benefit in accordance with the general rules.

IFSA considers that there are sound policy grounds for allowing tax free payments to permanently incapacitated members of superannuation funds. The existing rules impose an unfair burden on those persons having to cope with recent permanent disablement. Erosion of a disability benefit by a tax impost diminishes the ability of disabled members to fund their new lifestyles, and also increases the risk of these individuals becoming recipients of support from the Government's social security system."

Deduction for a trauma policy taken out through super

IFSA believes that where an individual takes out a trauma policy through super, they should receive a deduction for the premium, similar to that allowed for term life insurance and total & permanent disablement (TPD).

Trauma or Critical Illness insurance provides a cash lump sum on diagnosis of a medical condition. Largely, the medical condition is serious (or critical) such as cancer and heart attack, though not necessarily permanent.

Adequate trauma insurance removes the need for people to access their superannuation during the accumulation phase in order to pay for costly medical treatment. However, the absence of tax deductions for premium payments acts as a disincentive for this important product.

With escalating health care costs and an ageing population, IFSA believes that there are good policy grounds for offering a tax deduction on trauma cover taken out through superannuation. Consumers will be able to access group insurance rates, which are made available to large super funds, and a significant pool of private money will be available to

fund the cost of specialist treatment for critical illness, home modifications, wheel chairs, car modifications and mortgage repayments.

EFFICIENCY

Product Rationalisation

IFSA has previously identified the need for the introduction of a simplified, enduring legislative process for the restructuring and rationalisation of legacy financial services products.

The current lack of a single rationalisation process across financial products impedes systems enhancements and industry efficiency. Currently, there are some 6,000 financial products in the funds management, superannuation and life insurance industries. A third of these products are closed to new investment. Some of the benefits derived from the introduction of a single mechanism would be enhanced competitiveness, improved disclosure and reduced operational risk.

IFSA commends Treasury's consultation process to date, and supports the development and introduction of legislation in 2008.

CGT Rollover Relief for individuals moving from retail trusts into wholesale trusts

Currently, when an individual investor wishes to move out of a higher cost fund into a very similar lower cost fund (with substantially the same underlying assets), a capital gains tax (CGT) liability is triggered. IFSA believes that this creates a barrier to individual investors moving into a lower cost fund.

IFSA recommends that CGT rollover relief should be granted to those investors who voluntarily elect to move from a higher cost fund to a lower cost fund. We believe that individual consumers would directly benefit from the reduced fees offered by the lower cost fund, thereby increasing their potential returns. Furthermore, it would allow investors to exercise choice, through a greater flexibility to move out of those higher cost funds that no longer suit their investment strategy.

Notwithstanding the overall benefits to investors, IFSA is aware that, in order to ensure this relief is not abused, it must operate within an established framework. Such requirements will act as an integrity measure, such that investors will not simply be able to move between these funds on the basis of having merely made a poor investment choice. Details of IFSA's suggested approach can be provided upon request.

IFSA believes that as the investor will be taxed upon disposal of the units, the measure would be revenue neutral over time. Further, given that the relief being sought is of a limited nature in a specialist investment sector, IFSA does not anticipate that the granting of rollover relief in this area will provide a precedent for other sectors.

Uniform Life Insurance Model for Stamp Duty

IFSA supports the Government's push for greater uniformity in state regulation, including stamp duty. In particular, IFSA is keen to see the development and introduction of a uniform model to simplify and streamline the payment of life insurance stamp duties.

Currently, most states and territories have a different basis for levying stamp duty on life insurance: some are sum insured based; some are premium based; some have a combination; some have no duty on life insurance but loaded duties on rider benefits; the percentage of rates levied on life rider benefits vary from state to state and product to product. Furthermore, the total rate of duty payable varies from state to state.

IFSA members operate nationally and, given each of these variations, we believe that the current cost of collecting stamp duty for our members, as well as the State Revenue Offices, is likely to exceed the amount of revenue collected.

IFSA would welcome further discussion and consideration as to how uniformity in this area could be achieved, within the Intergovernmental Agreement (IGA) process.

Takeover provisions for funds management

IFSA recommends amendment of the takeover provisions of Chapter 6 of the Act, to facilitate market efficiency and to remove legal impediments that restrict the potential financial returns to investors in Australian managed funds.

The "20% rule" in Chapter 6, which limits the size of permitted holdings a person may have without making a bid, does not apply to fiduciary holdings where a person holds securities as a bare trustee (section 609(2)) or on behalf of someone else in the ordinary course of their financial services business (section 609(3)). In practice, however, these exceptions do not apply to fiduciary entities in the managed funds sector. Further, the 20% rule and the "minimum bid price rule" (section 621(3)) both apply to 'associates' of the bidder and can be triggered by the activities by other members of the fund manager's corporate group even when those activities are entirely unrelated to the takeover. Accordingly, under the current law:

- (a) holdings by a single fund manager for more than one underlying fund are aggregated for the purposes of the takeover thresholds;
- (b) holdings by one or more fund managers within a corporate group are aggregated with the non-fund holdings of the other members of the group;
- (c) where there is a takeover and a financial institution is the bidder or a consortium member, the ordinary course activities of any arm of the financial institution can inadvertently increase the interest of the bidder and the other consortium members above the 20% threshold in breach of the Act, even though those activities had nothing at all to do with the bid;
- (d) where there is a takeover and a financial institution is the bidder or a consortium member, the ordinary course activities of one arm of the financial institution might inadvertently increase the minimum takeover price that must be paid under the takeover bid, even though again those activities had nothing at all to do with the bid.

The current provisions in the Act, coupled with the growth in the Australian managed funds market have made it increasingly difficult for entities to stay below the existing 20% threshold and unduly limit the market for control. In addition, conglomerate financial institutions have to stop all trading in the securities in a bidder in lead up to a bid (which can be for several months), even where that trading is at arm's length and completely unrelated to the bid. That trading cessation by those other entities may itself constitute a breach of contract or breach of fiduciary duty. In essence, we believe that the laws are now longer up-to-date given the size and nature of Australian (and overseas) financial institutions.

We consider there is a real need, and a sound basis, to recognise the fiduciary holdings of an entity separately for the purposes of the takeover threshold requirements, to reconsider the 20% takeover threshold and, to put in place a more sophisticated takeovers regime that better recognises that today's conglomerate groups carry on a range of independent businesses.

Electronic Disclosure Documents

IFSA looks forward to working with the Government to rationalise and streamline the various disclosure documents. In doing so, we recommend that our regulatory environment should allow industry the full flexibility of using various IT solutions to communicate and do business with its clients.

We believe that all regulated documents should be provided to clients electronically where an electronic address is held for that client. In many instances, there is still a requirement for paper documents to be sent unless the client positively opts out. We estimate over 100 million pages of paper or 530 tonnes of paper were sent out last year for super confirmations alone, resulting in over \$85 million in administration costs.

In relation to annual reports the industry sends in the order of 35 million of these to its super and non-super investors. We know that these documents are not widely read. In the non-super area for example one company reported that out of 100,000 customers, *just 1200* requests were received for an annual report

IFSA believes that the wider use of electronic documents and the potential savings for consumers, business and the environment are significant.

We wish you well as you formulate your first Budget, and would welcome an opportunity to discuss the merits of these measures further.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Richard Gilbert', is positioned to the left of a vertical red line.

Richard Gilbert
Chief Executive Officer

Cc: The Hon. Chris Bowen MP
Assistant Treasurer and Minister for Competition Policy & Consumer Affairs

Senator the Hon. Nick Sherry
Minister for Superannuation and Corporate Law

Dr Ken Henry AC
Secretary to the Treasury
Department of the Treasury

Mr Jim Murphy
Executive Director
Department of the Treasury