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AFTS Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

Australia's Future Tax System

Submission: Enhancing the taxation of savings, assets and investments, including the role and structure of company taxation.

AXA Asia Pacific Holdings Ltd (AXA) has participated in submissions made by the Investment & Financial Services Association (IFSA) and is fully supportive of those recommendations. However as a large and successful financial services business operating throughout the Asia Pacific region, AXA is pleased to offer additional suggestions for improvement to the tax system.

1. Taxation of foreign active investment

1.1. The Controlled Foreign Companies (CFC) regime, in seeking to remove any incentive for mobile capital to locate in low tax countries, imposes a very onerous compliance obligation on companies operating active businesses (e.g. life insurance) in countries where the corporate tax rate is lower than in Australia (e.g. Hong Kong).

1.2. Section 446 requires additional tax specific computation of policy liabilities using Australian actuarial standards. It is submitted that where an Australian business is competing actively in a local market it should not have the Australian tax regime impose a calculation additional to that required for local regulatory purposes. Section 446 should permit the calculation of policy liabilities using the local regulatory regime.

1.3. Section 446, by virtue of its formulaic approach, assumes that all investment earnings derived by a foreign life company are proportionally derived by the Australian shareholder. This assumption is not valid as the crediting of investment income to policyholders is dictated by the terms and conditions of the policy document. For example, unit linked policies have 100% of investment income credited to the policyholder and none credited to the shareholder. It is therefore unfair to impose Australian tax on shareholders where no income has been derived for the benefit of the shareholder.

1.4. The 5% threshold of section 433 is an "all or nothing" test. That is, once 5% is breached then tax applies completely and not just to the amount above 5%. Volatile investment markets can make capital management very difficult and all efficient businesses strive to minimise the amount of capital employed in foreign countries. The current CFC regime makes it a bit of a lottery as to when Australian tax is imposed. A few dollars of portfolio movement can mean a company competing in a local market moves from nil

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Australian tax to tens of millions of dollars in Australian tax. It is submitted that the threshold in section 433 be lifted to 10% in line with FIF thresholds and that Australian tax apply to amounts above the threshold and not to the threshold itself.

1.5. An alternative (or additional) way to restrict the level of capital invested offshore is to only subject entities to accruals tax where there has been an insufficient repatriation of profit back to Australia. A suggested integrity measure is to grant a choice to companies to apply surpluses in their conduit foreign income account as a deduction against attributable passive income. This would mean that Australian tax would only apply where there has been inadequate repatriation of profit to Australia. It is submitted that such an approach would be consistent with the government's policy of creating a financial services hub and at the same time provide an integrity measure similar to that achieved through the franking system; that is, the exemption is limited to the amount of repatriation and prevents indefinite deferral of tax.

2. Foreign Investment Funds

2.1. In designing and marketing pooled investment products for Australian and international investors the prospect of compliance obligations under the FIF regime is a constant impediment. Designing a product to access foreign "private equity" funds is extremely difficult and often involves design features like and annual sale and re-acquisition to mitigate the almost impossible compliance obligations.

2.2. It seems that the historical policy intent has been to prevent indefinite deferral of Australian tax on passive income. It is submitted that this policy should be re-examined in light of the following:

2.2.1. The current policy of tax exemption for all Australians on income sourced from eligible superannuation funds. That is, passive income for retirees is already exempt.

2.2.2. To access money from a foreign fund there must be a redemption of units in an Australian managed trust - this is a taxing point in any event.

2.2.3. The inherent risks associated with foreign investment mean that tax is unlikely to be a dominant influence on any decision to invest in such products.

2.2.4. The FIF rules could perhaps mirror the CFC requirement that FIF only apply where 5 or fewer Australian investors own more than 40% of the units.

2.2.5. An obvious concern for the government is the opportunity to gear such investments such that deductions are claimed without commensurate recognition of income. For non-corporate investors, therefore, perhaps the solution is to limit deductions to the amount of taxable passive income returned (with carry forward of the surplus). Note that corporate investors already have thin capitalisation constraints and so additional limits on interest deductibility would not be required.

3. Capital losses

3.1. Volatile markets accentuate the constraining influence of having a quarantining of capital losses - they can be only carried forward and they can only be carried forward and offset against capital gains. In an environment where a company is excluded from any form of discount or indexation on capital gains, the restriction on the ability to deal with losses doesn't make sense to me. My view is that capital losses should be capable

of carry back for ordinary investors and should be offsettable against ordinary income for corporate taxpayers.

3.2. An example of inequities which can arise is where a unit trust is winding down and sells assets for gain in one year which are distributed to unit holders; and then the unit holder redeems units for loss in the following year. Such circumstances commonly arise in a winding-up situation. The inequity is obvious – tax paid on the gain in year one and a carry forward of the loss in the following year. The tax doesn't match the economic reality and causes expensive tax planning strategies to try and achieve the equitable outcome.

3.3. Consideration should be given to codifying definitions of capital and revenue for corporates as a lot of time is wasted on wrestling this distinction with the ATO.

4. Corporate Tax Rate

4.1. If we are serious about competing financially in our region then 30% is too high.

4.2. With Hong Kong, Singapore and Taiwan already under 20% I think we should be moving to 20% as soon as is affordable. The existing pressure for companies to distribute surplus capital to shareholders means that tax is quickly topped-up at personal rates. I acknowledge that AXA has a large foreign shareholding who would directly benefit from a lower Australian corporate rate. However AXA has performed strongly in Asian markets and brought back substantial profits from our successful offshore operations. Lowering our cost of capital can only assist in further building our businesses in the region.

I welcome the opportunity to participate in the development of a robust Future Tax System.

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Yours faithfully,

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