JL

30 October 2000

By Facsimile (02) 6273 2614 And Express Post

Assistant Commissioner
Law Design & Development (Entities)
Australian Taxation Office /
Federal Treasury (Tax Reform Section)
PO Box 900
Civic Square
CANBERRA ACT 2608

Dear Sir,

Re: ENTITY TAXATION – Non Fixed Trusts
SUBMISSION RE: INSURANCE BUY OUTS

We wish to make the following submission in relation to the proposed new arrangements for Non-Fixed Trusts.

In particular, we urge that there be expressly an inclusion in the definition of “Excluded Trusts” for Insurance Trust arrangements of the type described below:

1. The "Insurance Trust Arrangement for Equity Buy-Out" involves a non-fixed trust that is created for the sole purpose of holding insurance policies (life insurance and/or disablement policies or similar policies e.g. for trauma or disease) or the proceeds of such policies over the life of either a business proprietor or a business principal where the business is owed by a company or unit trust (and note, not confined to "small business") where the sole beneficiaries of the non-fixed trust are either the insured principal, or the surviving (or ongoing) principals, or their associated equity-holding entities, or the legal personal representatives (or heirs) of the outgoing (insured) principal.

2. Currently, the succession plans for many private businesses - whether large,
medium or small - are established in the form of a non-fixed trust where the said trustee holds the insurance policies so that the proceeds are available to finance the purchase of the equity of the deceased (or disabled or trauma-suffering) principal or the equity of his related equity-holder (i.e. the shareholding entity in the case of the business being owned by a company, or the unit-holding entity in the case of the business being owned

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by a unit trust) upon his departure, out of the proceeds of the insurance.

3. Section 118-30 of ITAA 97 (and its predecessor Section 160 ZZI of ITAA 36) has allowed a Capital Gains Tax exemption for the insurance proceeds where the trustee of the non-fixed trust is also the owner of the policy and has distributed the proceeds to the surviving beneficiaries as beneficiaries of that trust. The exemption that is available under Section 118-30 has been able to pass through to the beneficiaries.

4. The purpose of the Non-fixed trust is to finance the buy-out. The Taxation Office collects its capital gains tax revenue upon disposal of the shares/units/partnership interest but the use of a non-fixed trust (to hold the policy) is very important as it provides the means to finance the buy-out.

   The need for a non-fixed trust is determined by the fact that it is impossible to determine who will be the beneficiary (i.e. the survivor) until the CGT event occurs (i.e. the trigger event such as the death that triggers the disposal).

5. The use of a Non-fixed insurance trust is a most common form of financing structure for a buying-out of the deceased's family's equity in a business. There is no tax avoidance arrangement involved. It is a method of financing. The cost of this insurance is not tax deductible in any case.

6. To impose a corporate tax rate of 30% on the insurance proceeds would penalise the vendors with double taxation – and reduce the amount payable for the outgoing principal's equity - because capital gains tax will be payable in any event on the actual disposal of the business equity (e.g. shares of a company or units in a unit trust or proprietary equity in the case of a partnership). The insurance structure is merely a method for financing the acquisition. Why should there be a further 30% corporate tax on one's capital?

7. Public policy should encourage business proprietors to insure against death and reduce the likelihood of the government being called upon to assist the dependants of the deceased.

   The only reason for a non-fixed trust is the unpredictable nature of the event and the beneficiary – it depends on who dies (or has to leave because of a disablement or traumatic event such as a heart attack).

8. The arrangement is consistent with the tax exempt status of the insurance proceeds under the ITAA, as outlined above.

We trust that you will look favourably upon the matters raised in this submission.

Yours sincerely,

Joe Lederman
Partner**
BALDWINS
*	Accredited Specialist (L.I.V.) in Business Law
*	Accredited Specialist (L.I.V.) in Income Tax Law
Email: joeled@baldwins.com.au