Did you know?

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Henry Tax Review – Good, bad and ugly

On Sunday 2 May the government released the Henry Report along with its initial response to the review of Australia's tax system. In response to the 138 recommendations made in the report, the Treasurer has announced an initial package of targeted reforms to be phased in from 1 July 2012. This week's DYK will examine the potential impact on the life insurance industry.

Proposals adopted

Lower corporate tax rate

The report recommended a reduction in the corporate tax rate to 25%. In response, the government decided to reduce the rate to 29% for the 2013/14 income year and to 28% for the 2014/15 income year. Small business companies (those with turnover below $2 million) will apply the 28% rate from the 2012/13 income year.
For companies that receive life insurance proceeds (trauma and TPD) for key person capital, the CGT will be reduced.

Superannuation matters

The proposals announced by the government do not precisely match the report's recommendations but there is similarity. The changes announced will raise compulsory superannuation guarantee contributions from 9% to 12% over a period of nine years and will be extended to workers aged between 70 and 75.

From 1 July 2012 taxpayers on low incomes (<$37,000) will receive a government superannuation contribution equal to the contribution tax on their primary superannuation contributions up to a maximum of $500. It should be noted that low incomes will be determined on an 'adjusted taxable income' basis so salary packaging cannot be used to get below the threshold.

For individuals who choose to fund their insurance via superannuation, both of these measures are welcomed.

The $50,000 concessional contribution cap for those aged 50 and over will continue beyond 1 July 2012 provided the member has a superannuation balance less than $500,000. This will provide assistance for older employees with relatively low superannuation balances who are seeking to increase their retirement nest eggs. It should result in the continuation of salary sacrificing arrangements beyond 1 July 2012. The $500,000 cap is clearly intended to address policy concerns about the 'wealthy' exploiting superannuation. This is both good and bad news. Individuals who have small investment balances may use the higher concessional caps to fund insurance via super later in life. Those individuals who already have large accumulated balances in super will be restricted to $25,000 even after age 50, which is not favourable for those individuals who choose to do business succession planning via superannuation.

Proposals outright rejected

Align preservation age with pension age

As part of an earlier but separate paper on Retirement Income Strategic Issues, the Henry Review Panel recommended the preservation age be aligned to the Age Pension age. At the time, this was seen as the appropriate response to the increasing longevity of senior Australians. For example, the current gap between preservation age and the Age Pension age can result in individuals drawing down as much as a third of superannuation savings before age 65. This recommendation was directly aimed at enhancing the adequacy and sustainability of the retirement income system. However, the government has rejected this recommendation. This provides added emphasis on individuals protecting the gap between these two ages with adequate insurance.

Fringe Benefits Tax (FBT)

The report made a number of recommendations to simplify and reduce the scope of the FBT regime. The report recommends that fringe benefits that can be easily valued and attributed to individual employees should be taxed in the hands of the employee rather than the employer. Other fringe benefits should remain taxed to employers at the top marginal rate and be non-reportable for employees. In order to further simplify the FBT regime, the report has recommended that all existing FBT exemptions should be reviewed, the definition of fringe benefits should be narrowed and fringe benefits should be excluded where the costs of compliance outweigh the tax.

This has two detrimental effects for employees. Any employee who has an employer pay their life insurance premiums (outside of superannuation) will be taxed on this benefit, rather than the employer. Under the review, income protection insurances that are normally FBT-exempt (under the otherwise deductible rule) may lose this exemption.

Government annuities

The government has expressly ruled out introducing government annuity offerings, be they immediate or deferred, clearly preferring to leave any such activity to the private sector. This ensures the private sector annuities offered by life insurance companies will increase in popularity as the population continues to age.

Capital Gains Tax (CGT)

The report contained a recommendation that would introduce a uniform 40% savings income discount to individuals for non-business related income, which would implicitly be a reduction to the 50% CGT discount afforded to individuals on capital gains derived from the disposal of assets held for greater than 12 months. The discount could also potentially apply to capital losses (in line with any negative gearing deductions).

For those individuals who have buy-sell or key person capital arrangements, this would potentially increase the tax paid on both the receipt of the insurance proceeds and the disposal of the equity in the business.

The report recommends the abolition of all specific taxes on insurance leaving just the broad based GST. This would potentially reduce premiums on most insurances (not merely life insurance) making insurances more affordable.

Summary

The Henry Review has comprehensive recommendations for Australia's taxation system. At present, the government has only adopted a few of the recommendations, with limited impact on the life insurance industry.