Schedule 1

Application of the income tax law to financial claims scheme entitlements

Background

2.1 The *Financial System Legislation Amendment (Financial Claims Scheme and Other Measures) Act 2008* amended the *Banking Act 1959* and the *Insurance Act 1973* to establish a financial claims scheme (FCS). The scheme allows the Australian Prudential Regulation Authority (APRA) to pay depositors or policy holders in failed authorised deposit-taking institutions (ADIs) some part of their deposit, and to have that part of the depositor's right to recover their deposit transferred to APRA.[1] The remainder of the funds becomes available to the depositor at the liquidation of the ADI. Investment products such as superannuation, life insurance and managed funds are not covered by the scheme to avoid an undue 'incentive for consumers to pursue higher returns through risk-taking'.[2]

Purpose

2.2 The current legislation provides that if interest (or gain) has been paid to the depositor, he or she is assessable on that interest. However, if the interest has accrued but not yet been paid or credited to the depositor, 'the existing law may not treat the payments [by APRA]…in the same way as interest payment by the ADI'.[3]

2.3 The changes to the legislation ensure that payments made by APRA under the scheme are treated in a similar manner to those made by an ADI. The payments cover capital gains tax (CGT), farm management deposits (FMDs), retirement savings accounts (RSA), first home saver accounts (FHSA), reporting and withholding obligations.[4]

Farm management deposits

2.4 A farm management deposit (FMD) is 'a tax-linked financial risk management tool for eligible primary producers...to set aside income in profitable years for subsequent withdrawal in low-income years'. The proposed amendments to the legislation provide that the establishment of a new FMD by APRA or a liquidator as a result of a failed ADI is treated as a transfer of the old FMD for tax purposes. This

---

1 Explanatory Memorandum, p. 9.

2 Treasurer, The Hon Wayne Swan MP, 'New protections for depositors and policyholders', Media release 061, 2 June 2008.

3 Explanatory Memorandum, p. 10.

4 Explanatory Memorandum, p. 3.

ensures that FMD holders will have no adverse taxation implications where FMDs are held with failed ADIs.[5]

Retirement savings accounts

2.5 Retirement savings accounts (RSAs) are similar to superannuation funds and are treated comparably for income tax and superannuation purposes. The new legislation enables APRA to pay retirement payments into an RSA established in a new ADI, with payments treated for tax purposes as if they were a roll-over superannuation benefit. A payment directly to individuals is not considered appropriate because benefits in an RSA are generally preserved until retirement.[6]

First Home Saver Accounts

2.6 The First Home Saver Account (FHSA) initiative provides first home buyers a government contribution to their savings.[7] The proposed legislation will treat a payment from the scheme into a new FHSA as a transfer from one provider to another, to prevent the transfer from being eligible for the government contribution. Similarly to RSAs, a direct payment to individuals is considered inappropriate because 'there are restrictions on when an individual can get their money out of an FHSA'. The proposed amendments require the account holder to notify the new FHSA provider if they have become ineligible for the benefit in the period between the declaration of an ADI and the opening of a new FHSA.[8]

Reporting obligations

2.7 With regard to reporting obligations, currently investment bodies, excluding APRA, are required to provide the Commissioner of Taxation a written report relating to investments with the body. The proposed legislation imposes a similar requirement on APRA relating to the amounts paid under the scheme, and a requirement to provide an annual statement to account holders. If no payments are made, there is no requirement for a statement or a report. The proposed amendments allow APRA to require certain entities to provide information relevant to the annual statements or reports.[9]

---

5 Explanatory Memorandum, pp. 11–12, 14.

6 Explanatory Memorandum, p. 12, 27.

7 Treasury, First Home Saver Accounts, http://www.homesaver.treasury.gov.au/content/fact_sheet/Account_Holders.asp (accessed 2 April 2009).

8 Explanatory Memorandum, pp. 12–13, 28.

9 Explanatory Memorandum, pp. 16, 29–32.

Withholding obligations

2.8 In relation to withholding obligations, the proposed legislation ensures that the pay-as-you-go (PAYG) withholding provisions apply to payments under the scheme. That is, payments made by APRA to meet an entitlement under the scheme are treated as if they were made by an ADI. The provisions include the requirement that APRA withhold amounts and report and remit them to the Commissioner of Taxation. This amendment 'will help to ensure that taxpayers do not have unanticipated tax liabilities on assessment'.[10]

Financial impact

2.9 The financial impact is expected to be 'negligible' because of the tax outcomes being of equal value to the payments that would have been made by the financial or insurance institution. The compliance cost is expected to be low.[11]

10 Explanatory Memorandum, pp. 16, 33–34.

11 Explanatory Memorandum, p. 3.