Attachment O

APPLYING THE IMPUTATION SYSTEM TO NEW LIFE INSURANCE POLICIES

To ensure that investment returns are taxed at a policyholder’s marginal tax rate consistently with other investment products, the imputation system will apply to new life insurance policies.

Key features

The grossed-up amount of bonuses assigned to life insurance policies taken out after 30 June 2001 — that is, new life insurance policies — will be included in assessable income and policyholders will be entitled to refundable imputation credits. Policyholders will be able to choose a policy that allows for bonuses to be taxed annually or only on maturity or surrender. Low marginal tax rate policyholders will be able to take out a policy that allows for bonuses to be taxed annually and receive refundable imputation credits. High marginal tax rate policyholders will be able to defer the payment of tax by taking out a policy that only taxes bonuses on maturity or surrender.

The taxation treatment of bonuses paid from existing policies will remain unchanged.

- The rebate rate on existing policies issued by friendly societies and other registered organisations will be retained at the rate of 33 per cent for the 2000-01 and 2001-02 income years. That rebate rate will then be reduced to the company tax rate.
- The rebate rate on existing policies issued by life insurance companies will be retained at the rate of 39 per cent for the 2000-01 income year. That rebate rate will be reduced to 34 per cent in the 2001-02 income year and the company tax rate in subsequent income years.

Commencement

1 July 2001. In light of the concerns raised by life insurers about the need to develop new policies to cater for these changes, commencement of this measure has been deferred beyond the 2000-01 income year proposed in *A New Tax System*.

Current arrangements

If an existing policy is held for eight years or less, then bonuses paid on the policy are included in taxable income (or partly included in taxable income if the policy is held for nine or ten years) at the time the policy is surrendered or reaches maturity. The policyholder is entitled to a rebate to compensate for the tax paid by the life insurer. If the policy is held for more than 10 years, policyholders are exempt from tax on bonuses paid — that is, bonuses are effectively taxed at the company tax rate.

Why change is needed

Applying the imputation system to new life insurance policies will ensure that investment returns are taxed at a policyholder’s marginal tax rate consistently with other investment products.