



Professional Development Program

# Taxation of life insurance companies

Skilling module supplement:  
Glossary of abbreviations and terms

---

**Effective from  
1 January 2004**

**This is a module supplement  
for a series of seven on  
life insurance companies**

**For more information  
ATO staff can contact  
OCTC PWD New Law team**

**NAT 10885-06.2004**

## **Version**

This document incorporates legislative changes to 30 June 2003. This product is designed for printing and contains no interactivity.

## **Disclaimer**

The information in this publication is current at 30 June 2003 and we have made every effort to ensure it is accurate. However, if something in the publication is wrong or misleading and you make a mistake as a result, you will not be charged a penalty. You may have to pay interest, depending on the circumstances of your case.

You are protected under GST law if you have acted on any GST information in this publication. If you have relied on GST advice in this Tax Office publication and that advice has later changed, you will not have to pay any extra GST for the period up to the date of the change. Similarly, you will not have to pay any penalties or interest.

If you feel this publication does not fully cover your circumstances, please seek help from the Tax Office or a professional adviser. Since we regularly revise our publications to take account of any changes to the law, you should make sure this edition is the latest. The easiest way to do this is by checking for a more recent version on our website at [www.ato.gov.au](http://www.ato.gov.au).

# Contents

<b>1. Glossary</b>	<b>4</b>
1.1 Abbreviations	4
1.2 Terms	6
<b>2. Evaluation</b>	<b>17</b>

# About this module

## Background

This skilling module supplement has been published for the purposes of internal Tax Office training. However, due to industry requests, the module is made available to the public for general guidance. The information in it is provided in good faith, and any business decisions based on this material remain the sole responsibility of the enquiring party or anybody seeking to rely on it.

This skilling module supplement forms part of a set of modules published under the *Taxation of life insurance companies skilling modules* program. The collection of modules in this series are:

- *Module 1 – Introduction to life insurance in Australia*
- *Module 2 – Policy vision of Division 320*
- *Module 3 – Taxing structure of a life insurance company*
- *Module 4 – The complying superannuation class of a life insurance company*
- *Module 5 – Segregated exempt assets*
- *Module 6 – The ordinary class of taxable income*
- *Module 7 – Case study*
- *Module supplement – Glossary of abbreviations and terms (this module)*

## Using this skilling module

This module contains specific information in relation to this tax measure.

You should also ensure that you have access to:

- Any updates to this module which have been published to <http://www.ato.gov.au>, which can be found by searching for the term ‘life insurance skilling updates’.

## Materials

You will need access to the income tax legislation:

- *Income Tax Assessment Act 1936* (ITAA 1936)
- *Income Tax Assessment Act 1997* (ITAA 1997)
- *Income Tax (Transitional Provisions) Act 1997* (IT(TP)A 1997)

which is available on ATOLaw at:

<http://law.ato.gov.au/atolaw/index.htm>

# 1. Glossary

## ❖ 1.1 Abbreviations

## ❖ 1.2 Terms

---

### 1.1 Abbreviations

AASB	Australian Accounting Standards Board
AD/RLA	Accident & Disability/Residual Life Assurance
AFSA	Australian Friendly Societies Association
ANTS	A New Tax System
APRA	Australian Prudential Regulation Authority
ASFA	Association of Superannuation Funds of Australia Limited
ASIC	Australian Securities and Investment Commission
ATO	Australian Taxation Office
BTR	Business Tax Reform
BTRI	Business Tax Reform Implementation
CIB	Customer Information Brochure (see PDS)
CIV	Collective Investment Vehicles
CS	Complying Superannuation
CSC	Complying Superannuation Class
CS/RA	Complying Superannuation/Rollover Annuity
CTV	Current Termination Value
ETP	Eligible Termination Payment
FSIG	Financial Services Industry Group
IAA	Institute of Actuaries of Australia

IBNR	Incurred But Not Reported
IFSA	Investment and Financial Services Association
ISC	Insurance and Superannuation Commission
ITAA 1936	<i>Income Tax Assessment Act 1936</i>
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
NCS	Non-Complying Superannuation
PDS	Product Disclosure Statement (this replaced the Customer Information Brochure)
PST	Pooled Superannuation Trust
Ralph Report	A Tax System Redesigned, July 1999
RBL	Reasonable Benefit Limit
RBT	Review of Business Taxation
RSA	Retirement Savings Account
SEA	Segregated Exempt Assets
Virtual PST	Virtual Pooled Superannuation Trust

## 1.2 Terms

<b>Acquisition costs</b>	Marketing, administration and underwriting costs incurred by a life insurance company in acquiring a premium.
<b>Allocated pension</b>	An allocated pension operates in a similar fashion to an allocated <i>annuity</i> . An <i>allocated pension</i> requires the pensioner to make regular withdrawals from the account within certain legislated limits once they have retired. The pension continues until the death of the holder or until the account is exhausted.
<b>Anniversary</b>	Any anniversary of the commencement date of the <i>policy</i> .
<b>Annuity</b>	<p>An annuity is a policy under which a person called the annuitant pays a single premium to the life insurance company, and in return, the life insurance company makes regular payments to the annuitant for the rest of the annuitant's life, or for a defined term. An annuity may be payable to more than one person e.g. it may provide for reversionary payments, at a reduced rate, to the surviving spouse of the original annuitant.</p> <p>An allocated annuity is similar in nature to an allocated pension.</p> <p>There are two types of annuities: <i>immediate annuities</i> and <i>deferred annuities</i>.</p> <p><i>Annuity</i> is defined in subsection 995-1(1) of the ITAA 1997.</p>
<b>Benefit fund</b>	A benefit fund is used by a friendly society (that carries on life insurance business) in a similar way that life insurance companies use statutory funds. See also <i>statutory fund</i> .
<b>Best estimate liability</b>	As defined by the Valuation Standard (AS1.03), is the value of expected future payments and receipts under the policy, based on obligations at the reporting date.

**Bonus**

A bonus is the method for distributing a profit to a *policy owner*. The amount of the bonus in most cases is normally less than the allocated *profit*.

For participating *policies*, bonuses are often reversionary, that is, the bonus is payable only when the sum insured is payable.

A terminal bonus is a special bonus which may become payable only on a *policy* terminating in accordance with its terms.

Unbundled *policies* are generally non-participating. For *investment account policies*, the bonuses are an interest rate credited having regard to fund earnings. For investment-linked policies the insurer passes on the investment returns (net of fees) to the policyholder. The investment return may be positive or negative (see Farmer p.83)<sup>1</sup>

**Bundled policy**

A bundled policy is where the different components that comprise the *premium* cannot be identified or isolated. A *whole of life policy* or an *endowment policy* are examples of a bundled *policy*.

For more information on the components see *premium*.

**Capital Adequacy Standard**

The Capital Adequacy Standard is not used as basis of valuing policy liabilities for the purposes of Division 320. The Standard was established under the *Life Insurance Act 1995* and is administered by APRA. Capital Adequacy Standard AS3.03 applies from 30 June 2002. It relates to a two tier capital requirement on the statutory funds of a life insurance company. The first tier relates to the solvency of the company ('the solvency requirement') and the second tier relates to securing the financial soundness of the company as a going concern ('the capital adequacy requirement'). It should be noted that AS3.03 does not use the same concept of 'tier'

---

<sup>1</sup> Farmer, J. (1998) *Roadmap to Life Insurance Products*, CCH Publishing, Sydney. (Updates found at <http://www.ozemail.com.au/~jfarmer/roadmap.html>)

	as is used in relation to the banking industry; i.e. there is no division between upper and lower Tier 2 capital.
<b>Capital guaranteed</b>	See <i>investment account</i> .
<b>Complying superannuation class of taxable income</b>	See definition in section 320-140 of the ITAA 1997.  Is that part of the total taxable income that consists of: <ul style="list-style-type: none"> <li>• if the company is an RSA provider – the RSA component</li> <li>• if the company has established a virtual PST – the virtual PST component</li> <li>• the specified roll-over component.</li> </ul>
<b>Continuous Disability Policy</b>	A <i>Continuous Disability Policy</i> has the meaning given by section 9A of the <i>Life Insurance Act 1995</i> .
<b>Current Termination Value (CTV)</b>	The <i>Current Termination Value</i> of a life insurance policy, or of the net risk component of a life insurance policy, has the meaning given in the Solvency Standard.  Note that from 30 June 2002, life insurance companies and friendly societies are covered by Solvency Standard 2.03.  The CTV is the amount that the <i>policy owner</i> of an investment policy (which does not contain participating or discretionary benefits) would get back if they cancelled their insurance <i>policy</i> after the <i>life insurance company</i> takes out any <i>fees</i> . During the early years of an insurance <i>policy</i> , the establishment <i>fees</i> generally exceed the value of the life insurance <i>policy</i> . The longer the <i>policy</i> is held, the larger the CTV becomes.
<b>Customer information brochure (CIB)</b>	See <i>Product Disclosure Statement</i> .

<b>Deferred annuity</b>	<p>A deferred annuity is an annuity that is not presently payable (subsection 995-1(1) ITAA 1997). A deferred annuity is a life insurance <i>policy</i> that allows a <i>life insurance company</i> to hold eligible termination payments (ETP) between the time the ETP is paid and the time the <i>policyholder</i> turns age 65. For example, a person aged 55 purchases an <i>annuity</i> today, but does not receive any income from that <i>annuity</i> for ten years.</p> <p>See <i>annuity</i> for more information.</p>
<b>Defined fee</b>	<p>A defined fee is a fee that a life insurance company can ascertain without completing an actuarial valuation of its assets and liabilities.</p>
<b>Emerging fee</b>	<p>An emerging fee is a fee that can only be determined as a consequence of an actuarial valuation of the assets and liabilities of the life insurance company.</p>
<b>Endowment</b>	<p>There are two types of endowment policies.</p> <p>An endowment policy is similar in concept to a whole of life policy. The basic distinction is that an endowment policy will have a nominated maturity age, e.g. 65. The sum insured will be paid either when the life assured dies or when the life assured survives to the maturity age.</p> <p>Pure endowment policies also have a defined maturity age. If the life assured survives to the maturity age, the sum insured is paid. However, if the life assured dies before the maturity age, there is no payment of a death benefit. Instead, there is a return of the premiums paid, usually accumulated at a low rate of interest.</p>
<b>Fee</b>	<p>A fee is a sum payable to a person or company for performing their function. Refer to <i>defined fee</i> and <i>emerging fee</i> for more information on how fees are charged by <i>life insurance companies</i>.</p>

<b>Friendly society</b>	<p>A <i>Benefit Fund</i> is used by a friendly society (that carries on life insurance business) in a similar way that life insurance companies use Statutory Funds. A friendly society uses benefit funds to segregate its business, with each benefit fund containing a single type of product. For more information see <i>Statutory fund</i>.</p> <p>See also <i>Life insurance company</i>.</p>
<b>Immediate annuity</b>	<p>An immediate annuity is an annuity that is presently payable (subsection 995-1(1) ITAA 1997).</p> <p>An immediate annuity is an <i>annuity</i> that is currently due or will become due for payment within the next twelve months. Immediate annuity payments are made at the end of each payment period (i.e. they are paid in arrears).</p> <p>An annuity consists of two types: traditional annuities (term certain and life annuities) and allocated annuities.</p> <p>Refer to <i>annuity</i> for further explanation.</p>
<b>Insurance bonds</b>	<p>Insurance bonds are investment products. The <i>policy owner</i> invests a single <i>premium</i> or a number of premiums with the <i>life insurance company</i>. After the removal of <i>fees</i> levied by the <i>life insurance company</i>, the remaining <i>premium</i> is invested in a pooled fund. The pooled fund may be <i>investment account</i> or <i>investment-linked</i>.</p>
<b>Insured</b>	<p>Where a payment under a life insurance contract is contingent on the death, survival or disability of a particular person, this person is known as the insured. An alternative term used in the industry is ‘assured’.</p>
<b>Investment account</b>	<p>An investment account policy is one where a running balance is maintained of the debits and credits to the <i>policy</i>. Credits will comprise the value of new <i>premiums</i> and earnings. Debits will consist of withdrawals and charges. Investment account <i>policies</i> are often non-participating unbundled <i>policies</i></p>

and will usually give capital guarantees. The balance of the account is maintained in a pooled fund. Life insurance cover is frequently included in the *policy*.

<b>Investment-linked</b>	An investment-linked policy is one where the provision of benefits is calculated by reference to units in a pooled fund, the value of which is related to the market value of a specified class or group of assets. The unit price is calculated daily to reflect the investment performance of the assets in the fund. The benefit is paid on death or when the policyholder terminates the policy.
<b>Life insurance company</b>	<p>A life insurance company is also known as a Life Insurer. Companies that are registered under the Life insurance Act include:</p> <ul style="list-style-type: none"><li>• life insurance companies</li><li>• life reinsurance companies, and</li><li>• friendly societies that carry on life insurance business</li></ul> <p>This includes investment business and/or risk business.</p>
<b>Net current termination value</b>	Means so much of the current termination value that relates to that part of the policy that is not reinsured
<b>Net premiums</b>	Amount of premium reduced by any part of the premium that is reinsured under a contract of reinsurance.
<b>Net risk component</b>	The risk component of the policy in respect of that part of the policy that is not reinsured.
<b>Non participating policy</b>	<p>A policy which does not participate in distributions of <i>profit</i>, e.g. <i>term life insurance</i> and investment-linked policies.</p> <p>Another name for a non participating <i>policy</i> is a ‘without <i>profits policy</i>’.</p>
<b>Ordinary business</b>	<p>See <i>Ordinary class of taxable income</i></p> <p>All business that is not in the <i>complying superannuation</i> class of taxable income.</p>

<b>Ordinary class of taxable income</b>	Total taxable income less the complying superannuation class of taxable income. The ordinary class is taxed at the corporate rate.
<b>Participating policy</b>	<p>A <i>policy</i> entitled to participate in distributions of <i>profit</i>, eg, most traditional <i>whole of life</i> and <i>endowment policies</i> are participating.</p> <p>Another name for a participating <i>policy</i> is a ‘with <i>profits policy</i>’.</p>
<b>Policy</b>	A <i>policy</i> is a contract between a <i>life insurance company</i> and <i>policy owner</i> . The <i>life insurance company</i> then issues a document to the <i>policy owner</i> once the <i>proposal</i> has been accepted. The <i>policy</i> will contain the obligations of both parties to the contract.
<b>Policyholder</b>	See <i>Policy owner</i> . These terms are used interchangeably.
<b>Policy owner</b>	<p>Upon acceptance by the insurer of the <i>proposal</i>, the purchaser becomes known as the <i>policy owner</i>. As such, the owner obtains the following:</p> <ul style="list-style-type: none"> <li>• the right to terminate the <i>policy</i></li> <li>• the ability to receive benefits arising from the <i>policy</i></li> <li>• the right to transfer ownership of the <i>policy</i>, and</li> <li>• an obligation to pay premiums under the terms of the <i>policy</i>.</li> </ul>
<b>Policy year</b>	A period of 12 months from one <i>anniversary (of a policy)</i> to the next.
<b>Premium</b>	<p>A premium can have three components:</p> <ul style="list-style-type: none"> <li>• an expense component to cover the cost of the <i>policy</i></li> <li>• an investment component, and</li> <li>• a mortality or risk component to cover the cost of death cover.</li> </ul> <p>A premium can be bundled or unbundled.</p>

<b>Product Disclosure Statement (PDS)</b>	A PDS contains the information for a retail investor to understand the product they are buying. The PDS replaced the customer information brochure for life insurance products.
<b>Proposal</b>	A proposal represents the application form which a person must complete to purchase a life insurance product. It is contained within the <i>Product Disclosure Statement</i> .
<b>Reinsurance</b>	<p>Reinsurance is where a <i>life insurance company</i> (transferor) insures with another <i>life insurance company</i> (transferee) to cover the transferor for any potential liability it may have on its <i>policies</i>. In other words, the risk is being transferred from one <i>life insurance company</i> to another. A transfer of <i>premium</i> will also occur proportionate to the risk being transferred.</p> <p>A company may reinsure to avoid an over exposure to too much risk.</p>
<b>Pure risk policies</b>	Risk products are products which might be regarded as “pure insurance”. A <i>premium</i> is paid and the <i>policy owner</i> receives a benefit on the occurrence of the event which was insured eg. death, or a specified event such as a stroke.
<b>Risk business</b>	Business of a life insurance company which deals with death, disability and trauma products.
<b>Secondary market</b>	The secondary market allows an investor to buy insurance <i>policies</i> at a discount and reap the benefits as the <i>policy</i> matures. The investor pays a higher price than the original owner would have received if it was discontinued.
<b>Smoothing</b>	In years when the earned rate is high, the insurer may declare a lower interest rate than the pooled fund earned and the excess investment earnings are set aside as an “investment fluctuation reserve”. In years when the earned rate is low (or even negative), funds may be released from the investment fluctuation reserve to allow the

*life insurance company* to declare a higher interest rate than the pooled fund earned.

Most *investment account* products give the *life insurance company* considerable discretion in determining the declared rate. For some products the declared interest rate is determined by a formula stated explicitly in the *policy* document.

**Solvency Standard**

The Solvency Standard is a first tier capital requirement to ensure solvency.

The definition of Solvency Standard in subsection 995-1(1) ITAA 1997 refers to Actuarial Standards 2.02 for life insurance companies other than friendly societies and 2.01 for friendly societies that conduct life insurance business. Note that from 30 June 2002 life insurance companies and friendly societies are covered by Solvency Standard 2.03.

**Statutory fund**

All life insurance (other than life insurance conducted by friendly societies) is conducted through statutory funds. Statutory funds provide for separate accounting of the *policy owner* business and assets from the shareholder business and assets. Each year the company is required, under the *Life Insurance Act 1995*, to prepare financial accounts for each statutory fund and calculate the *profit* of each statutory fund. It must be emphasised that a statutory fund is not a bank account.

**Superannuation**

Superannuation is a long term savings arrangement which operates primarily for retirement. Superannuation savings are usually made through trust funds, and if these funds meet prescribed government standards, they are eligible for tax concessions.

See Quinlivan, B., 1994, *The Dictionary of Superannuation*, Client Publishing Australia Pty Ltd, Melbourne, Australia, p.109.

**Surrender value**

Represents the cash value if a *policy owner* terminates the *policy*.

**Term life**

This type of insurance is the basic form of

<b>insurance</b>	life insurance. It provides maximum death cover at minimum cost. Pure protection without any savings or investment element.
<b>Traditional policy</b>	A traditional policy is a type of <i>policy</i> that was popular until the 1970s. Examples of traditional <i>policies</i> are <i>whole of life</i> and <i>endowment</i> insurance.
<b>Unbundled policy</b>	<p>An unbundled policy is a <i>policy</i> where the investment, risk and administration components of the <i>policy</i> are separated and the <i>premium</i> in respect of the different components can be clearly identified.</p> <p>For more information on the components refer to <i>premium</i>.</p>
<b>Underwriting</b>	Underwriting involves the <i>life insurance company</i> examining the person listed as the <i>life insured</i> on the <i>proposal</i> form for the purpose of determining whether to accept or reject the <i>proposal</i> . Common steps which the <i>life insurance company</i> may employ include requesting the applicant to complete a health and lifestyle questionnaire, and undergoing a medical examination. While many applicants who are accepted will pay the standard <i>premium</i> rate, in some instances a <i>proposal</i> may be accepted but be subject to a higher than normal <i>premium</i> eg smokers.
<b>Valuation Standard</b>	The definition of Valuation Standard in subsection 995-1(1) ITAA 1997 refers to Actuarial Standards 1.02 (life insurance companies other than friendly societies) and 1.01 (friendly societies). Please note that, from 30 June 2002, these Standards have changed to 1.03 and 1.02 respectively.

**Whole of life policy**

A whole of life insurance policy is structured on the understanding that an individual will pay the required premiums for virtually the whole of their life. The premium does not change (excluding indexation), and is determined by the age of the individual when the contract is taken out.

A whole of life policy combines elements of both risk protection and savings. For example, a whole of life policy guarantees payment of the sum insured on death (the risk protection element), while also providing a share in the life insurer's profits by means of an annual reversionary bonus (the savings element).

A whole of life policy can also be cashed in, or surrendered, prior to maturity, however the time at which the policy owner decides to cash in the policy will determine what amounts are received in return. Generally, if a policy owner decided to surrender such a policy within 5 years of taking it out, the policy owner can expect to receive returns which do not exceed the premiums that were paid.

## 2. Evaluation

To help us improve our products, we would appreciate your feedback on this skilling module supplement.

You can send us your comments using the ‘Feedback’ link on the Tax Office website home page at <http://www.ato.gov.au> and then selecting the ‘skilling modules’ feedback menu option.