TD 2015/D6 - Income tax: will a dealing between a life insurance company and another entity in relation to a segregated asset(s) of the company, undertaken by the company solely for the purpose of maintaining a pool of assets out of which to discharge its complying superannuation/FHSA life insurance policy liabilities or exempt life insurance policy liabilities, effect the transfer of an asset(s) 'from' or 'to' the company's complying superannuation/FHSA asset pool or its segregated exempt assets (within the meaning of Division 320 of the Income Tax Assessment Act 1997)?

This document has been finalised by TD 2015/17.

Draft Taxation Determination

Income tax: will a dealing between a life insurance company and another entity in relation to a segregated asset(s) of the company, undertaken by the company solely for the purpose of maintaining a pool of assets out of which to discharge its complying superannuation/FHSA life insurance policy liabilities or exempt life insurance policy liabilities, effect the transfer of an asset(s) 'from' or 'to' the company's complying superannuation/FHSA asset pool or its segregated exempt assets (within the meaning of Division 320 of the *Income Tax Assessment Act 1997*)?

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Ruling

1. No. A life insurance company does not 'transfer' an asset (whether money or an asset other than money) 'from' its complying superannuation/FHSA assets (CS assets) or its segregated exempt assets (SEAs) (hereinafter referred to collectively as 'segregated assets'), for the purposes of Division 320 of the *Income Tax Assessment Act 1997* (ITAA 1997),[1] when it disposes of the asset in a dealing with another entity undertaken by the company solely for the purpose of maintaining a pool of assets out of which to discharge its complying superannuation/FHSA life insurance policy liabilities or exempt life insurance policy liabilities.

[1] All legislative references are to the ITAA 1997 unless otherwise indicated.

2. Nor does a life insurance company transfer an asset 'to' its CS assets or its SEAs, for the purposes of Division 320, when it acquires the asset (whether money or an asset other than money) in exchange for a segregated asset, or as the return on a segregated asset, in a dealing with another entity undertaken by the company solely for the purpose of maintaining a pool of assets out of which to discharge its complying superannuation/FHSA life insurance policy liabilities or exempt life insurance policy liabilities.

3. A dealing between a life insurance company and another entity of the kind described will not trigger the taxation consequences that apply under Division 320 when an asset is transferred from or to the company's complying superannuation/FHSA asset pool or from or to the company's SEAs (see, for example, sections 320-15, 320-87, 320-105, 320-200 and 320-255).

Date of effect

4. When the final Determination is issued, it is proposed to apply both before and after its date of issue. However, the Determination will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination (see paragraphs 75 to 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation
17 June 2015

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached. It does not form part of the proposed binding public ruling.

5. This draft Determination considers the operation of Division 320 when a life insurance company disposes of a segregated asset in exchange for another asset or assets and/or obtains a return upon a segregated asset in a dealing with another entity, undertaken by the company for the sole purpose of maintaining a pool of assets out of which to discharge its complying superannuation/FHSA life insurance policy liabilities or exempt life insurance policy liabilities

Background

6. In Australia, life insurance companies are registered and regulated under the *Life Insurance Act 1995* (LIA).

7. The principal object of the LIA is 'to protect the interests of the owners and prospective owners of life insurance policies in a manner consistent with the continued development of a viable, competitive and innovative life insurance industry'.[2]

8. Under the LIA, life insurance business is broadly defined as business that consists of issuing and undertaking liabilities in relation to life insurance and similar policies.[3] Such business includes the investment of the life insurance company's funds. The acquisition and realisation of investments are acts in carrying on that business. In this ruling, we use the term 'business' in this same sense.

9. A distinctive characteristic of a life insurance business is that the customer relationship between a life insurance company and its policy holders may last for many years. The LIA therefore requires life insurance companies to invest in a way which will allow them to meet both their current and long term policy commitments. They must also be able to pay their expenses and operating costs, and provide a commercially viable return to their shareholders.

Division 320

10. Life insurance companies are taxed under the general provisions of the income tax law and under industry specific rules in Division 320.

11. The objects of Division 320 include ensuring that life insurance companies are taxed on all of their profits and that they are taxed in a broadly comparable manner to other entities that derive similar types of income.[4]

12. Income generated on complying superannuation/FHSA life assets is taxed at a rate of 15%; income generated on segregated exempt assets is non-assessable non-exempt (NANE); fee income relating to that business and income from any remaining business, such as risk business and ordinary investment business, is taxed at the corporate tax rate.

[2] Subsection 3(1) of the LIA.
[3] Section 11 of the LIA.
[4] See paragraphs 5.1 and 5.10 of the Explanatory Memorandum to the New Business Tax System (Miscellaneous) Bill (No. 2) 2000 (Explanatory Memorandum).

13. In furtherance of these objects, Division 320 allows life insurance companies to segregate their assets between those which relate solely to their complying superannuation/FHSA life insurance policy liabilities (CS assets)[5] and those which relate solely to their exempt life insurance policy liabilities (SEAs).[6] Any unsegregated assets would relate to the remainder of the life insurance company's business and to its shareholders' capital, shareholders' retained profits, and its reserves (hereinafter referred to as ordinary assets).[7]

14. The principal purpose of segregating the assets is to facilitate the working out of the taxable income or tax losses of the ordinary and complying superannuation/FHSA classes, and the NANE income in relation to segregated exempt assets.

Segregated assets

15. Whilst Division 320 does not define what it means to 'segregate' an asset, in the statutory context it is apparent that assets will only qualify as CS assets or SEAs if it can be demonstrated that the life insurance company has set them apart or otherwise dedicated them solely for the purpose of discharging either its complying superannuation/FHSA life insurance policy liabilities or its exempt life insurance policy liabilities, as the case may be.

16. The question of whether an asset is being held or dealt with for the relevant sole purpose must be determined objectively in all the circumstances. Relevant evidence would include any records maintained by the company for accounting, financial, taxation, and/or prudential purposes.

17. Assets will be set aside or dedicated in the requisite way where it is evident from the nature of the assets and from the way in which the life insurance company has invested and/or otherwise dealt with them, that they form part of a pool of assets accumulated by the company, over time, to back the company's complying superannuation/FHSA life insurance policy liabilities (in relation to CS assets) or its exempt life insurance policy liabilities (in relation to SEAs).[8]

18. Broadly speaking, such a pool would comprise of those assets in which the life insurance company has invested to meet relevant policy liabilities and related expense payments. Typically, although not necessarily, the company would acquire the assets from related premiums and investment returns. The company's investment strategy would be informed by an understanding of the main characteristics and risk profiles of the underlying policy liabilities.[9]

Transfers to or from segregated assets

19. Division 320 prescribes the circumstances in which a life insurance company may or must transfer assets to or from its segregated assets; it also provides for such transfers to be taken into account in calculating the taxable income of a life insurance company.

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[5] Subdivision 320-F.
[6] Subdivision 320-H.
[7] Note, for prudential purposes, shareholders' capital, shareholders' retained profits and reserves may be allocated to the statutory funds that Part 4 of the LIA requires life insurance companies to maintain in relation to certain kinds of life insurance business.
[8] Sections 320-170, 320-195, 320-225 and 320-250.
[9] Institute of Actuaries of Australia, *The Practice of Life Insurance in Australia: Course 2A*, Chapter 10, 2009.

20. The voluntary 'transfers' which Division 320 permits a company to make are transfers:

- 'to' or 'from' segregated assets where the asset being transferred is exchanged for cash equal to the value of the asset (see subsections 320-185(2), 320-195(2), 320-240(2) and 320-250(1))
- 'to' segregated assets to make up a deficit between the transfer value of either the CS assets or the SEAs and the amount required to discharge the complying superannuation/FHSA life insurance policy liabilities or the exempt life insurance policy liabilities, respectively, at a particular time (a valuation must be made at the end of each income year) – conceptually, the taxation law views any such deficit as a loss to the ordinary business (see subsections 320-180(3) and 320-185(1), 320-235(3) and 320-240(1))
- 'to' segregated assets where the assets being transferred have a value that does not exceed the amount of the life insurance premiums paid to the company in that year (see subsections 320-185(3) and 320-240(3)), or
- 'from' CS assets 'to' SEA where the transfer is occurring because a life insurance policy has become an exempt life insurance policy (see subsection 320-195(1)).

21. The mandated asset 'transfers' are those which a company is required to make 'from' its segregated assets whenever:

- it determines that the transfer value of either the CS assets or the SEAs exceeds the amount required to discharge the complying superannuation/FHSA life insurance policy liabilities or the exempt life insurance policy liabilities, respectively, at a particular time (a valuation must be made at the end of each income year) - conceptually, the taxation law views any such surplus as a profit or fee to the ordinary business (implicit fees) (see subsections 320-180(1), 320-195(3), 320-235(1) and 320-250(2)), or
- it imposes fees or charges in respect of its segregated assets or relevant policies (explicit fees) (see subsections 320-195(3) and 320-250(2)).

22. Such 'transfers' attract certain taxation consequences, namely:

- the transfer value of the asset may be included in the assessable income of the life insurance company and/or allowed as a deduction (see sections 320-15, 320-87 and 320-105), and
- for 'non-money' assets, the life insurance company will generally be deemed to have sold and repurchased the asset for a consideration equal to its market value (see sections 320-200 and 320-255).

23. These taxation consequences are imposed in order to ensure that the implicit and explicit fees charged by the company in respect of its complying superannuation/FHSA life insurance policies and exempt life insurance policies are properly brought to tax and to prevent tax planning opportunities from arising from internal dealings designed to take advantage of differences in the taxation rates of each class.[10]

[10] See old and new law comparison table following paragraph 5.13 of the Explanatory Memorandum.

24. Specifically, the rules that assess and deduct the transfer values of the reallocated assets have the effect of treating any value transferred 'from' the segregated assets as a fee that is taxable at the corporate tax rate in relation to the ordinary class of the life insurance company and as a loss or outgoing in relation to the complying superannuation/FHSA life insurance policy class and exempt life insurance policies. This loss or outgoing is treated as being deductible at 15% in relation to the complying superannuation/FHSA class, but is not deductible in relation to the segregated exempt assets due to income in relation to these assets being treated as NANE.

25. Conversely, any value transferred 'to' the segregated assets is treated as a loss or outgoing in relation to the ordinary class and is deductible at the corporate tax rate, and as a gain that is taxable in relation to the complying superannuation/FHSA class at 15% but which is not taxable in relation to the segregated exempt assets.

26. The rules that deem an asset to have been sold upon transfer ensure that any gains that have accrued prior to the transfer are realised at that time and brought to tax at an appropriate tax rate (that is, at the corporate tax rate, 15% or nil), noting that any losses on such transfers are deferred.[11]

27. Similarly, the tax cost of the transferred asset is reset to market value by the deemed repurchase so only gains accruing after the transfer will be recognised at a later realisation date; for example, upon a further deemed sale or an actual sale to another entity.

What constitutes a 'transfer'?

28. Ordinarily, internal dealings within a single entity do not have any legal effect and do not usually attract tax consequences.

29. However, the concept of 'transfer' adopted in subsections 320-170(7) and 320-225(6) is very broad.

30. According to subsections 320-170(7) and 320-225(6), a reference to a 'transfer' of an asset to or from the segregated assets is a reference to the inclusion of the asset amongst the segregated assets, or the exclusion of the asset from the segregated assets, as the case may be.

31. On its face this could encompass both internal dealings and any routine investment dealings undertaken by a life insurance company in respect of a segregated asset.

32. For example, a life insurance company that disposes of a segregated asset to another entity in exchange for another asset could be said to have 'excluded' the first asset 'from' its segregated assets and 'included' the second asset amongst its segregated assets. Similarly, a life insurance company that derives a return upon a segregated asset could be said to have 'included' the return (whether it be in cash or some other form) amongst its segregated assets.

[11] Subsections 320-200(3) and 320-255(3).

33. A purposive construction of Division 320,[12] however, supports a narrower construction of 'transfer'. On this view, the transfer provisions are only intended to apply to internal reallocations of assets such as occur when there is a change in the purpose for which a life insurance company holds an asset.

34. Support for this view lies in the absence of any obvious policy basis for treating a routine market value transaction involving the disposal of an asset to another entity as a 'transfer'. Such a transaction will be a realisation event for tax law purposes and any accrued but previously unrealised gains on the relevant asset would be brought to account for tax purposes by operation of the general income tax provisions. As such there does not seem to be any mischief upon which the deemed sale and repurchase provisions would need to operate.

35. Further, whilst subsections 320-170(7) and 320-225(6) provide that a reference to a transfer is a reference to an asset's inclusion among or exclusion from the segregated assets, as the case may be, those provisions do not stipulate that they cover the transfer of an asset to or from another entity.

36. Indeed, a comparison of the different approaches taken within Division 320 to investment income versus premium income suggests that Division 320 was drafted on the basis that investment income on segregated assets would be received wholly for the purposes of discharging the complying superannuation/FHSA life insurance policy liabilities or exempt life insurance policy liabilities, whereas premium income would be received, at least in part, for the purposes of the ordinary business.

37. Specifically, paragraph 320-137(2)(a) provides that assessable income derived by a company from the investment of its CS assets in relation to the period during which those assets were CS assets will be assessable income taken into account in working out the complying superannuation/FHSA class of taxable income. Notably, the provision is not supported by any other provisions permitting or requiring the assets representing the investment income to be transferred from the life insurance company's ordinary assets to its CS assets. The underlying assumption is that assets comprising the investment income are necessarily held for the same purpose as the assets that produced them.[13]

38. On the other hand, the combined effect of paragraph 320-15(1)(a), sections 320-55, 320-60, 320-65, 320-70, and 320-75, and subsections 320-185(3) and 320-240(3), is to permit a life insurance company to transfer assets representing the value of life insurance premiums obtained by it in relation to relevant life insurance policies to its segregated assets, albeit with certain taxation consequences. The assumption underlying these provisions appears to be that because life insurance premiums are the price a life insurance company receives for assuming a liability, they may be received by the company partly or wholly for the purposes of its ordinary business. Some but not all types of premiums may be transferred to the segregated assets, although even when the policy is of a type which may be supported by segregated assets, the company is not obliged to do so.[14]

[12] See *CIC Insurance Ltd v. Bankstown Football Club Ltd* (1997) 187 CLR 384; [1997] HCA 2 at CLR 408 per Brennan CJ, Dawson, Toohey and Gummow JJ and also *Project Blue Sky Inc v. Australian Broadcasting Authority* (1998) 194 CLR 355; [1998] HCA 28 at CLR 381.

[13] This is consistent with the prudential approach to statutory funds. For example, section 34 of the LIA provides that the assets of a statutory fund include assets or investments obtained by the application of other assets of the fund or the expenditure of money held in the fund.

[14] See for example the choice concerning whether a policy is to be met out of segregated assets implicit in subsections 320-190(1) and 320-245(1).

39. Similarly, sections 320-195 and 320-250 distinguish between the explicit and implicit fees imposed by a life insurance company in respect of its complying superannuation/FHSA assets or life insurance policies or segregated exempt assets or exempt life insurance policies and amounts that the company pays other entities, including policy holders, to discharge policy liabilities or to pay expenses incurred by the company in relation to segregated assets. When a company imposes an explicit or implicit fee it is required to 'transfer' assets from the segregated assets equal in value to the fees so imposed (see subsections 320-195(3) and 320-250(2)). In contrast, when it discharges liabilities or incurs expenses to other entities it is required to 'pay' from the segregated assets any amounts required to discharge the liabilities or equal to the expenses - an intermediate transfer to the ordinary class assets is not required (see subsections 320-195(4) and 320-250(3)).

Example 1

40. *Life Co derives interest on arm's length market value investments in securities which it holds as SEAs. The assets received by way of interest are taken for Division 320 purposes to be included directly among the SEAs rather than being transferred to the SEA via Life Co's ordinary assets.*

Example 2

41. *Life Co applies money held by it for the purpose of discharging its complying superannuation/FHSA life insurance policy liabilities to meet expenses incurred by it in respect of its CS assets. Life Co is not to be taken, for Division 320 purposes, to have transferred an asset from its CS assets to its ordinary assets.*

Example 3

42. *Life Co disposes of SEAs and reinvests the proceeds in replacement assets. The transactions are arm's length market value transactions. After acquiring the assets, Life Co uses them solely for the purpose of maintaining a fund capable of discharging its exempt life insurance policy liabilities. Life Co is not to be taken for Division 320 purposes to have transferred assets from the SEA to its ordinary assets or to its SEAs from its ordinary assets.*

Example 4

43. *Life Co holds membership interests in an investment vehicle as CS assets. In the course of a commercially driven restructure, it exchanges the membership interests for membership interests of equivalent value. Provided the assets disposed of and acquired are used for the relevant sole purpose, the exchange is not to be taken for Division 320 purposes to constitute the transfer of assets from or to Life Co's CS assets. Subject to all its requirements being met, Life Co could qualify for a replacement asset roll-over under Division 124 in respect of the exchange.*

Example 5

44. *When Life Co obtains premiums from entering into exempt life insurance policies, its accounting system allocates them directly to SEAs. For Division 320 purposes the relevant funds are taken to have been received by the company as ordinary assets with a subsequent transfer of assets to its SEAs under subsection 320-240(3).*

Dealings that don't meet the sole purpose requirement

45. It is beyond the scope of this Determination to specify the situations when dealings between a life insurance company and another entity in relation to the company's segregated assets will be consistent with the company using those assets for the sole purpose of discharging the company's complying superannuation/FHSA life insurance policy liabilities or exempt life insurance policy liabilities.

46. It would be ordinarily expected that most of a life insurance company's dealings in respect of the investment and management of its segregated assets would meet this criterion.

47. However, it can be expected that the Commissioner will have particular regard to this criterion where it appears that a life insurance company has entered into a dealing in relation to a segregated asset that results in value being shifted away from segregated assets. Particular consideration will be given to:

- whether the dealing results in a transfer from the segregated assets (by way of an implicit or explicit fee)
- whether the assets representing the shifted value are still held within the segregated pool for Division 320 purposes (notwithstanding this might be contrary to the internal booking of the assets), and
- whether there has been a failure of segregation (likely only to apply in extreme circumstances).

Appendix 2 – Your comments

48. You are invited to comment on this draft Determination. Please forward your comments to the contact officer by the due date.

49. A compendium of comments is prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments, and
- be published on the ATO website at www.ato.gov.au.

Please advise if you do not want your comments included in the edited version of the compendium.

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- Life insurance company

Legislative references:

- ITAA 1997
- ITAA 1997 Div 124
- ITAA 1997 Div 320
- ITAA 1997 Subdiv 320-F
- ITAA 1997 Subdiv 320-H
- ITAA 1997 320-15
- ITAA 1997 320-15(1)(a)
- ITAA 1997 320-55
- ITAA 1997 320-60
- ITAA 1997 320-65
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- LIA 1995
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Cases relied on:

- CIC Insurance Ltd v. Bankstown Football Club Ltd (1997) 187 CLR 384; [1997] HCA 2
- Project Blue Sky Inc v. Australian Broadcasting Authority (1998) 194 CLR 355; [1998] HCA 28

Other references:

- Explanatory Memorandum to the New Business Tax System (Miscellaneous) Bill (No. 2) 2000
- Institute of Actuaries of Australia, The Practice of Life Insurance in Australia: Course 2A, Chapter 10, 2009

ATO references

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