IT 2147 - Income tax : personal guarantees backed by life insurance contracts

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TAXATION RULING NO. IT 2147

INCOME TAX : PERSONAL GUARANTEES BACKED BY LIFE INSURANCE CONTRACTS

F.O.I. EMBARGO: May be released

REF

*** NOTE: THIS RULING HAS BEEN MODIFIED BY IT 2346

H.O. REF: 84/2591-4 DATE OF EFFECT: Immediate

B.O. REF: DATE ORIG. MEMO ISSUED:

F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1174869	INSURANCE : LIFE POLICIES	
	GUARANTOR OF LOANS - PERMANENT	25
	POLICIES ON GUARANTOR OF LOANS	26(h)
	- ASSESSMENT OF PROCEEDS	51
	ASSESSABLE INCOME : PROCEEDS OF	63(3)
	LIFE INSURANCE POLICIES PAID TO	67
	COMPANIES	159R

OTHER RULINGS ON TOPIC IT 155

PREAMBLE Advice has been sought in relation to the deductibility of life insurance premiums paid by directors of companies who are required to provide personal guarantees to support bank overdraft and other credit facilities provided to the company for the purpose of carrying on its business.

FACTS 2. It has been suggested on one hand that such directors of companies who enter into these arrangements seek to effect insurance contracts to the extent of their possible liability under such guarantees as collateral security in the event of premature death or permanent disablement.

3. Information available also suggests that the policies of insurance are contracted for so as to insulate the guarantor's possible liability in respect of the company's debts from the guarantor's personal estate. This is so as to protect the next of kin in the event of the premature death of the guarantor.

4. It has not been suggested that any payout under such policies would be assigned to the company and it appears that on the death of the director (whether premature or not) the proceeds of the policy would form part of the personal estate or would be payable to the next of kin.

5. Whether the deceased director's estate would be called on to honour the guarantee would depend upon many factors such

as the liquidity of the company, the existence of other guarantors, terms of the loan agreement, etc. It is not difficult to imagine that only in a minority of cases would the proceeds of the policy be actually used to pay out the company's obligations because of the guarantor's obligations to the lender. Meanwhile, the policy has insulated the guarantor's personal assets from the company's liabilities.

6. It appears that in some instances the company agrees to pay the guarantor a fee in consideration for the guarantor executing the personal guarantee. Whether the fee is really paid to reimburse the guarantor for the premiums of life assurance seems to depend upon the facts of the case.

RULING

7. A fee paid by a company to a director (or other person) in consideration for that person agreeing to guarantee repayment of borrowings by the company will normally be an allowable deduction to the company within the terms of section 67 only.

8. Such fees are assessable income in the hands of the person acting as guarantor under either section 25 or paragraph 26(h).

9. Premiums paid by a guarantor for a policy of life insurance, whether whole of life or not, on the guarantor's life come within the terms of section 159R but are not allowable deductions within the terms of section 51. The proceeds of such a policy will not be assessable income in the hands of the guarantor or the guarantor's estate.

10. If the proceeds of such a policy are assigned to the company the proceeds may be assessable income of that company within the terms of section 25 or paragraph 26(j), Carapark Holdings Ltd v FCT (1966) 115 CLR 653, 14 ATD 402, 10 AITR 378. That will depend upon the circumstances of each case. Where the policy of life insurance was taken out for the purpose of enabling the guarantor to meet the contingent obligations under the guarantee and was assigned to the company for the purpose of satisfying its obligations under the loan agreement then the proceeds will be of a capital nature, c.f. Development Underwriting Ltd v. FCT (1971) 2 ATR 337, 71 ATC 4125. The relevant purpose will be the purpose at the time of assignment unless it is clear that there has been a change of purpose after that time. In this regard continuation of the policy for the benefit of the company after the guarantee has become ineffective because the loan has been repaid, or for any other reason, will be prima facie evidence that the policy is a key-man policy and any proceeds would be assessable income of the company. If the policy has been assigned to the lender, to the extent that the proceeds of the policy represent unpaid interest, those proceeds will be assessable income of the lender and consideration may also need to be given to the operation of sub-section 63(3).

11. Premiums paid by a company in respect of policy of life insurance on the life of a guarantor are to be dealt with in accordance with Taxation Ruling No. IT 155.

COMMISSIONER OF TAXATION
29 March 1985

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