PR 2021/11 - Tax consequences for Australian policyholders of a Quilter executive investment bond

Status: **legally binding**

Product Ruling

Tax consequences for Australian policyholders of a Quilter executive investment bond

Relying on this Ruling

This publication (excluding appendix) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

If this Ruling applies to you, and you correctly rely on it, we will apply the law to you in the way set out in this Ruling. That is, you will not pay any more tax or penalties or interest in respect of the matters covered by this Ruling.

[**Note:** *This is a consolidated version of this document. Refer to the Legal database* (ato.gov.au/law) *to check its currency and to view the details of all changes*.]

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No guarantee of commercial success

The Commissioner **does not** sanction or guarantee this product. Further, the Commissioner gives no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential participants must form their own view about the commercial and financial viability of the product. The Commissioner recommends a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential participants by confirming that the tax benefits set out in the **Ruling** part of this document are available, **provided that** the scheme is carried out in accordance with the information we have been given, and have described below in the **Scheme** part of this document. If the scheme is not carried out as described, participants lose the protection of this Product Ruling.

Terms of use of this Product Ruling

This Product Ruling has been given on the basis that the entity(s) who applied for the Product Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Product Ruling.

Status: **legally binding**

What this Ruling is about

1. This Product Ruling sets out the Commissioner's opinion on the way in which the relevant provisions identified in the Ruling section apply to the defined class of entities that takes part in the scheme to which this Product Ruling relates.

2. All legislative references in this Product Ruling are to the *Income Tax Assessment Act 1936* (ITAA 1936) unless otherwise indicated. In this Product Ruling, terms defined in the Executive Investment Bond Policy Terms (ref EIB4) referred to in paragraph 17 (the Policy Terms) have been capitalised.

3. In this Product Ruling the scheme involves the purchase and holding of an Executive Investment Bond (EIB) issued by Quilter International Isle of Man Limited (Quilter)[A1] subject to the Policy Terms.

4. This Product Ruling does not address:

- the tax consequences arising in relation to an EIB held by a Policyholder that is not a resident of Australia for taxation purposes during the period on or after 1 July 2021 and on or before 30 June 2024
- the treatment of any fees or charges (including the Premium) incurred in connection with an EIB
- the assessability (or otherwise) of amounts received under an EIB, other than under
  - section 26AH, and
  - the capital gains tax regime in Part 3-1 of the *Income Tax Assessment Act 1997* (ITAA 1997)
- a Policyholder's entitlement (or otherwise) to a rebate under section 160AAB in relation to an assessable bonus received under an EIB
- the capital gains tax consequences arising from the assignment of ownership of an EIB to another entity for consideration, and
- whether a Policyholder makes forex realisation gains or losses under Division 775 of the ITAA 1997.

Class of entities

5. This part of the Product Ruling specifies which entities can rely on the Ruling section of this Product Ruling and which entities cannot rely on the Ruling section.

6. The class of entities that can rely on the Ruling section of this Product Ruling consists of:

(a) Those entities that purchase an EIB subject to the Policy Terms (the Policyholder) on or before 30 June 2024 and, subsequent to that purchase and during the period on or after 1 July 2021 and on or before 30 June 2024, are a resident of Australia for taxation purposes.

[A1] On 21 October 2022, Quilter changed its name to Utmost International Isle of Man Limited. From 21 October 2022, all references to 'Quilter' in this Product Ruling should be read to mean 'Utmost International Isle of Man Limited.

(b) Entities to which ownership of an EIB subject to the Policy Terms is assigned for no consideration (also a Policyholder) on or before 30 June 2024 and, at the time of, or subsequent to, that assignment and during the period on or after 1 July 2021 and on or before 30 June 2024, are a resident of Australia for taxation purposes.[1]

(c) Where a Policyholder referred to in subparagraphs 6(a) or (b) of this Product Ruling is also the Relevant Life Assured and dies:

(i) an entity nominated as a beneficiary by the Policyholder, or

(ii) the deceased estate of the Policyholder.

7. The class of entities that can rely on the Ruling section of this Product Ruling does **not** include entities that are not one of the entities listed in paragraph 6 of this Product Ruling.

Superannuation Industry (Supervision) Act 1993

8. This Product Ruling does not address the provisions of the *Superannuation Industry (Supervision) Act 1993* (SISA). The Commissioner gives no assurance that the scheme is an appropriate investment for a superannuation fund. The trustees of superannuation funds are advised that no consideration has been given in this Product Ruling as to whether investment in this scheme may contravene the provisions of the SISA.

Qualifications

9. The class of entities defined in this Product Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 17 to 40 of this Product Ruling.

10. If the scheme actually carried out is materially different from the scheme that is described in this Product Ruling, then this Product Ruling:

- has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled, and
- may be withdrawn or modified.

Date of effect

11. This Product Ruling applies prospectively from 1 July 2021. It therefore applies only to the specified class of entities that:

- enter into the scheme, and
- are a resident of Australia for taxation purposes during the period from 1 July 2021 to 30 June 2024, being its period of application (this Product Ruling will continue to apply to those entities even after its period of application has ended, as long as the Policyholder remains a resident of Australia for taxation purposes).

[1] All references to 'Policyholder' in this Product Ruling are a reference to a Policyholder as described in both or either of subparagraphs 6(a) or (b) of this Product Ruling unless otherwise indicated.

12. However, the Product Ruling only applies to the extent that there is no change in the scheme or in the entity's involvement in the scheme.

Changes in the law

13. Although this Product Ruling deals with the income tax laws enacted at the time it was issued, later amendments may impact on this Product Ruling. Any such changes will take precedence over the application of this Product Ruling and, to that extent, this Product Ruling will have no effect.

14. Entities that are considering participating in the scheme are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Note to promoters and advisers

15. Product Rulings were introduced for the purpose of providing certainty about income tax consequences for entities in schemes such as this. In keeping with that intention, the Commissioner suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Product Ruling has issued.

Ruling

Application of this Ruling

16. Subject to paragraph 4 of this Product Ruling and the assumptions in paragraph 40 of this Product Ruling:

- (a) The EIB is an 'eligible policy' for the purposes of section 26AH.
- (b) Any portion of a Surrender Value or part surrender benefit received by a Policyholder under an EIB and comprising an adjustment for earnings referable to the Assets represented by the cancelled Allocated Units (as per paragraph 34 of this Product Ruling) is an amount as or by way of a 'bonus' for the purposes of section 26AH, and
  - (i) assessable under subsection 26AH(6) when received during the eligible period in relation to the EIB, and
  - (ii) is not otherwise assessable as ordinary or statutory income under the ITAA 1936 or the ITAA 1997.
- (c) Where, having regard to the matters listed in paragraph 26AH(8)(b), the Commissioner is of the opinion that it would be unreasonable for subsection 26AH(6) to apply (as per paragraph 16(b) of this Product Ruling) to any portion (or to part of any portion) of a Surrender Value received by a Policyholder by reason of their total surrender of their EIB, and which constitutes an amount as or by way of a bonus, subsection 26AH(6) will not apply to that amount (subsection 26AH(8)).
- (d) No portion of a Surrender Value or part surrender benefit received by a Policyholder under an EIB otherwise than as or by way of a bonus shall, for the purposes of subsection 26AH(6), be deemed pursuant to subsection 26AH(9) to have been received by the Policyholder under the EIB as or by way of a bonus.

(e) Pursuant to subsection 26AH(5), an accretion in the value of the Portfolio Fund linked to a Policyholder, as calculated on a Valuation Date, is not regarded as having been received by the Policyholder for the purposes of assessment under subsection 26AH(6).

(f) A Policyholder is not, for the purposes of assessment under subsection 26AH(6), taken to have received an amount under or in relation to an eligible policy pursuant to subsection 26AH(4) as a result of 'switching' the Assets in the Portfolio Fund linked to them.

(g) Any portion of an amount

(i) transferred from the Portfolio Fund (by surrender of Allocated Units for their Surrender Value) to Units in a Fixed Account, and

(ii) received by a Policyholder from Quilter as an interest-free loan (as per the circumstances set out in paragraphs 26 and 27 of this Product Ruling)

which comprises an adjustment for earnings referable to the Assets represented by the surrendered Allocated Units, will, for the purposes of subsection 26AH(6), be deemed pursuant to subsection 26AH(9) to have been received by the Policyholder under the EIB as or by way of a bonus (subsection 26AH(11)).

(h) Where, during the eligible period in relation to an EIB a Policyholder receives an amount of consideration in respect of an assignment of that EIB, that consideration (or part of it, as the case may be) will, for the purposes of subsection 26AH(6), be deemed pursuant to subsection 26AH(9) to have been received by the Policyholder under the EIB as or by way of a bonus if the Commissioner is of the opinion that the consideration (or part of it) is attributable to a bonus that has accrued or has been declared in respect of the EIB, or a bonus that can reasonably be expected to accrue in respect of the EIB (subsection 26AH(12)).

(i) Pursuant to subparagraph 26AH(7)(a)(i), no portion of a Death Benefit paid under an EIB is assessable under subsection 26AH(6).

(j) Where the Premium payable by a Policyholder in respect of an EIB in relation to an assurance year exceeds the Premium payable under that EIB in the immediately preceding assurance year by more than 25%, subsection 26AH(13) applies to deem the 10-year eligible period in respect of the EIB to have commenced at the beginning of the year in which the premium was increased (rather than at the date of commencement of the period in respect of which the first premium under the EIB was paid).

(k) Table item 3 of subsection 118-300(1) of the ITAA 1997 disregards any capital gain or capital loss made by a Policyholder referred to in paragraph 6(a) of this Product Ruling resulting from the payment to them under an EIB of a

(i) Surrender Value or part surrender benefit upon total or part surrender of their EIB, or

(ii) Death Benefit upon the death of the Relevant Life Assured (where the Policyholder is not a life assured)

(l) Table item 4 of subsection 118-300(1) of the ITAA 1997 disregards any capital gain or capital loss made by a Policyholder referred to in paragraph 6(b) of this Product Ruling resulting from the payment to them under an EIB of a

(i) Surrender Value or part surrender benefit upon total or part surrender of their EIB, or

(ii) Death Benefit upon the death of the Relevant Life Assured (where the Policyholder is not a life assured)

(m) Any capital gain or capital loss made by the nominated beneficiary or the deceased estate of a Policyholder, as applicable, resulting from the payment to them under an EIB of the Death Benefit upon the death of the Policyholder (as the Relevant Life Assured) is disregarded pursuant to table item 4 of subsection 118-300(1) of the ITAA 1997.

(n) Provided the scheme ruled on is entered into and carried out as described in this Product Ruling, the anti-avoidance provisions in Part IVA will not apply to an entity referred to in paragraph 6 of this Ruling.

Scheme

17. The scheme that is the subject of this Product Ruling is identified and described in the following documents:

- application for a Product Ruling as constituted by information and documentation received on 18 June 2021 and 15 April 2024
- the Executive Investment Bond Policy Terms, effective as of June 2015 and last updated in November 2020 (with reference EIB4) and effective for EIBs entered into on or after 30 September 2019, and
- the Executive Investment Bond Policy Terms (with reference EIB4) effective for EIBs entered into on or after 25 October 2021.

Note: Certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

18. For the purposes of describing the scheme to which this Product Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which an entity referred to in paragraph 6 of this Ruling, or any associate of such entity, will be a party to, which are a part of the scheme.

19. Quilter, registered in the Isle of Man, issues (among other products) EIBs. Entities (Policyholders) capable of purchasing an EIB from Quilter are not residents of Australia for taxation purposes at the time of issue.

20. At the Policyholder's discretion, an EIB is issued in the form of a single Policy or a number of separate Policies (known as a Cluster of Policies) each representing an equal proportion of the EIB.

21. Full details of the EIB, including the commitments and rights of both Quilter and a Policyholder, are contained in the Policy Terms. The Policy Terms are interpreted in accordance with, and are governed by, the law of the Isle of Man.

Portfolio Funds and Units

22. To enable calculation of the benefits and charges under an EIB, Quilter creates notional units (referred to as Allocated Units or Units), each representing a proportionate share of the value of the Assets in a Portfolio Fund linked to the Policyholder's EIB. The Assets in the Portfolio Fund linked to the Policyholder are chosen by the Policyholder (or their Fund Adviser or Intermediary) from a broad selection of asset classes, subject to Quilter's acceptance, and may be changed by instruction from the Policyholder (or their Fund Adviser or Intermediary).

23. Allocated Units are allocated whenever a Premium is paid by the Policyholder and credited by Quilter to the Policyholder's Transaction Account, an account Quilter keeps to buy and sell Assets for the Portfolio Fund linked to the Policyholder, as well as for the payment of benefits. The percentage of the Policyholder's Premium used to calculate the number of Units allocated to their EIB each time they pay a Premium is referred to as the Allocation Percentage.

24. The value of the Portfolio Fund (and the price of the Allocated Units) is determined on the Contract Date and on each quarterly Valuation Date (Quarterly Date) thereafter.

25. While the Policyholder legally owns their EIB, they have no legal or beneficial interest in the Units, Portfolio Fund or any of the Assets therein, which remain the property of Quilter. Any appointed Custodian under the terms of the EIB is therefore custodian of Quilter, not the Policyholder.

Fixed Account loan withdrawals

26. The Policyholder may at any time request that an amount less than the Surrender Value (as explained in paragraph 29 of this Product Ruling) be transferred from the Portfolio Fund (by surrender of Allocated Units for their Surrender Value) to Units in a Fixed Account. A Fixed Account is a separate and identifiable account maintained by Quilter for the purpose of granting interest-free loans.

27. The Policyholder may borrow up to the amount of the value of their Units in the Fixed Account (if any) interest-free. Repayment of such a loan may be made by the Policyholder while their EIB remains in force. On repayment, the:

- sum-standing to the credit of the EIB in the Fixed Account will be reduced by cancelling Units equal in value to the sum repaid, and
- amount repaid will be treated as an additional Premium credited to the Policyholder's Transaction Account.

28. As the Fixed Account does not earn interest or participate in capital growth, Units allocated in it maintain the same value at all times.

Surrender of a Policy

29. The Policyholder can surrender one or more of their Policies and receive the Surrender Value, being the value of the Allocated Units allocated to the Policy (or Policies), less any outstanding charges.

30. Where the Policyholder totally surrenders one or more of their Policies:

- Quilter arranges for the sale of the Assets in the Policyholder's Portfolio Fund on the first dealing date administratively available to pay the Surrender Value

- Quilter cancels the Allocated Units in the Policyholder's Portfolio Fund, and
- the surrendered Policy (or Policies) ends, and no further benefits are payable.

31. Where the Policy ends by total surrender, the amount of any yet-to-be repaid loan procured by a Policyholder and funded by a transfer of funds to a Fixed Account (as per paragraph 26 of this Product Ruling) will be offset against the Surrender Value payable to the Policyholder.

32. Any part surrender of a Policyholder's Cluster of Policies may, on request by the Policyholder, be made regularly (each month, two months, quarter, four months, six months or year, subject to minimum withdrawal limits and minimum Portfolio Fund value at the time), and must be made by selling Assets in each of those Policies.

33. The Policyholder can provide Quilter with instructions as to which Assets to realise to pay a part surrender benefit. If Quilter pays the Policyholder a part surrender benefit then it will cancel Allocated Units to pay the benefit based on the price of those Units on the preceding Quarterly Date (or the Contract Date if there is none).

34. Any Surrender Value or part surrender benefit paid to the Policyholder on total or part surrender respectively consists of the Premium allocated to the cancelled Allocated Units, as adjusted for any earnings referrable to the Assets represented by those Allocated Units.

35. The Policyholder has no right to payment of the Surrender Value or part surrender benefit, as applicable, other than on surrender of their EIB either in whole or in part.

Death benefit

36. The EIB is a whole-of-life assurance policy providing for a payment of a Death Benefit on the death of the Relevant Life Assured. Where multiple lives are assured under an EIB, the Relevant Life Assured is the last of the lives assured to die. A life assured under an EIB may or may not be that of the Policyholder.

37. The Death Benefit payable by Quilter is 101% of the Surrender Value, calculated on the Final Valuation Date that the last of the Assets have been realised and credited to the Transaction Account.

38. On payment of the Death Benefit the Allocated Units (subject to all Assets being sold or disposed of) will be cancelled, and (subject to paragraph 39 of this Product Ruling) no further benefit will be payable by Quilter under the EIB.

39. If there are any Units standing to the credit of the EIB in a Fixed Account then their value will also become payable on the death of the Relevant Life Assured. This part of the Death Benefit will be 100% of the value of the Units in the Fixed Account.

Assumptions

40. This Product Ruling is made on the basis of the following necessary assumptions:

(a) A nominated beneficiary referred to in paragraph 6(c)(i) of this Product Ruling is an Australian resident for taxation purposes at the time of receipt of a Death Benefit under the EIB.

(b) A Policyholder's deceased estate, referred to in paragraph 6(c)(ii) of this Product Ruling, is an Australian-resident trust estate as defined in subsection 95(2) at the time of receipt of a Death Benefit under the EIB.

(c) A Policyholder referred to in paragraph 6(a) of this Product Ruling is the original owner of the EIB they purchased.

(d) All dealings between any of the entity's referred to in paragraph 6 of this Product Ruling and Quilter will be at arm's length.

(e) The scheme will be executed in the manner described in the Scheme section of this Product Ruling and the scheme documentation referred to in paragraph 17 of this Product Ruling.

Commissioner of Taxation
29 September 2021

Appendix 1 – Explanation

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

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Application of section 26AH to the executive investment bond

41. Subsection 26AH(6) includes all, or part of, amounts received as, or by way of, bonuses under certain life assurance policies (eligible policies), which, but for section 26AH, would not be included in the assessable income of the recipient, in the assessable income of the recipient when received within ten years of the date on which the first or only premium paid under the policy was paid (eligible period).

The executive investment bond is an eligible policy

42. An 'eligible policy' in respect of which section 26AH may apply is defined in subsection 26AH(1) to mean 'a life assurance policy in relation to which the date of commencement of risk is after 27 August 1982, other than a funeral policy (as defined in the *Income Tax Assessment Act 1997)* issued on or after 1 January 2003'.

43. The term 'life assurance policy' is defined in subsection 6(1) as having the meaning given to 'life insurance policy' by the ITAA 1997. A 'life insurance policy' is defined in subsection 995-1(1) of the ITAA 1997 as having the meaning given to the expression 'life policy' in section 9 of the *Life Insurance Act 1995*.

44. A contract of insurance that provides for the payment of money on the death of a person, and a contract (whether or not it is a contract of insurance) that constitutes an investment-linked contract, both constitute a life policy under paragraphs 9(1)(a) and (g) of the *Life Insurance Act 1995*.

45. Some of the more general features of an investment-linked policy are described in paragraphs 5 and 6 of Taxation Ruling IT 2346 *Income tax: bonuses paid on certain life assurance policies – section 26AH – interpretation and operation* as follows:

> 5. … A contract providing a death benefit, and an investment account the value of which is directly linked to the performance of a specific investment portfolio. The value of the policyholder's interest will rise and fall with the movements in the value of the portfolio.
>
> 6. Premiums in respect of an unbundled policy may be paid in a lump sum or annually, or the policyholder may elect to vary the amount of the premium by making additional

payments under the policy at any time. A further feature of these types of policies is that they generally allow the policyholder to surrender a part of the policy at any time (a 'partial surrender').

46. An EIB issued to a Policyholder referred to in paragraph 6 of this Product Ruling is an eligible policy for the purposes of section 26AH as it:

- has a date of commencement of risk, being the date of commencement of the period in respect of which the first premium paid under the EIB is paid, which is after 27 August 1982
- is not a 'funeral policy', as defined in subsection 995-1(1) of the ITAA 1997, and
- is a life assurance policy by virtue of it constituting a life policy pursuant to paragraphs 9(1)(a) and (g) of the *Life Insurance Act 1995*.

Treatment of benefits received under the executive investment bond

47. The term 'bonus' is not defined for the purposes of section 26AH but is explained at paragraph 8 of IT 2346 in the context of 'more traditional policies' as a guaranteed addition to the amount insured, payable when the amount insured is payable and representing both a form of participation by the policyholder in the issuing company's profits and a share in the surpluses derived by the issuing company during the period the policy is in force. Such a bonus, where received under an eligible policy that matures or is surrendered, forfeited or otherwise terminated within the eligible period of ten years after commencement, falls within the scope of section 26AH.

48. The portion of a Surrender Value or any part surrender benefit comprising an adjustment for earnings referrable to the Assets represented by the cancelled Allocated Units, and paid by Quilter from the balance of the Transaction Account maintained for each Policyholder that owns an EIB, is considered to have characteristics that are consistent with the description of a bonus in IT 2346. These characteristics include relating and being linked to a life assurance policy, being additional to the Death Benefit payable upon the death of the Relevant Life Assured, and providing the Policyholder with participation in Quilter's profits, as derived from the Assets in the Portfolio Fund linked to the Policyholder (but owned by Quilter) during the period the Policyholder's EIB is in force.

49. Payments of a bonus by Quilter from the balance of the Transaction Account maintained under an EIB are therefore subject to section 26AH and are not assessable under any other provision of the ITAA 1936 or the ITAA 1997. Specifically, a bonus received under an EIB is included as assessable income of a Policyholder pursuant to subsection 26AH(6) to the following extent:

- in full, where it is received during the first eight years of the eligible period
- as to two-thirds of the amount received, where it is received during the ninth year of the eligible period
- as to one-third of the amount received, where it is received during the 10^{th} year of the eligible period, and
- nil, where it is received after the 10^{th} year of the eligible period.

50. To ensure that bonuses or other amounts in the nature of bonuses are not subject to tax unless the total amount received by the policyholder under an eligible policy (that is, amounts previously received (including any amounts of bonus) and the surrender value at the time of forfeiture, surrender or other termination) exceeds the premiums paid under

that eligible policy, subsection 26AH(8) provides, subject to any other matters the Commissioner considers relevant, a discretion for the Commissioner to exclude from assessable income the whole, or part of, an amount received as, or by way of, a bonus by reason of the forfeiture, surrender or other termination of an eligible policy, and which would otherwise be included in assessable income by the application of subsection 26AH(6) (see paragraph 10 of IT 2346).

51. Where a policyholder receives an amount under an eligible policy within the eligible period otherwise than as, or by way of, a bonus, that amount is assessable under subsection 26AH(6) as if it had been received as a bonus to the extent that, in the Commissioner's opinion, it represents a bonus that has accrued or been declared, or a bonus that can reasonably be expected to accrue – see subsection 26AH(9). No portion of a Surrender Value or part surrender benefit received by a Policyholder under an EIB otherwise than as or by way of a bonus (as referred to in paragraph 16(b) of this Product Ruling) shall be deemed pursuant to subsection 26AH(9) to have been received by the Policyholder as if it had been received as or by way of a bonus.

52. Subject to subsection 26AH(5), subsection 26AH(4) operates to ensure that where an amount payable under an eligible policy is reinvested or otherwise dealt with on behalf of or at the direction of the policyholder, they are taken to have received that amount under or in relation to that policy. Subsection 26AH(6) does not, however, apply to bonuses that are merely notionally credited during the life of the policy but cannot actually be received until it ends. In this regard, subsection 26AH(5) provides that subsection 26AH(4) does not apply to an amount in relation to an eligible policy that is reinvested or otherwise dealt with on behalf of or at the direction of the policyholder so as to increase the surrender or maturity value that might reasonably be expected to be received under the policy.

53. An accretion in the value of the Portfolio Fund linked to a Policyholder, as calculated on a Valuation Date, constitutes a bonus that is merely accrued so as to increase the amount ultimately payable to the Policyholder on part or total surrender of their EIB, and pursuant to subsection 26AH(5) is not regarded as having been received by the Policyholder for the purposes of assessment under subsection 26AH(6).

54. A facility which allows policyholders of investment-linked policies to reclassify or vary the class or classes of assets supporting the policy is known as 'switching'. The rights or entitlements of the policyholder under the policy remain unchanged following exercise of the switching option, except that the future value of the policy will be calculated by reference to different assets, and subsection 26AH(4) does not apply in the manner explained in paragraph 52 of this Product Ruling – see Taxation Determination TD 94/82 *Income tax: does section 26AH of the Income Tax Assessment Act 1936 apply when investment options are 'switched' under an eligible policy?* Switches of the Assets in the Portfolio Fund linked to the Policyholder involves the mere variation in the calculation base of their EIB such that subsection 26AH(4) does not apply, for the purposes of assessment under subsection 26AH(6), to take the Policyholder to have received an amount under or in relation to their EIB.

55. Where a policyholder receives an amount by way of an interest-free loan from the assurer in connection with an eligible policy, that amount is assessable under subsection 26AH(6) as if it had been received as a bonus to the extent that, in the Commissioner's opinion, it represents a bonus that has accrued or been declared, or a bonus that can reasonably be expected to accrue – subsections 26AH(9) and (11). An interest-free loan received by a Policyholder from Quilter in connection with an EIB will, for the purposes of subsection 26AH(6), be deemed pursuant to subsection 26AH(9) to have been received by the Policyholder as or by way of a bonus to the extent that the amount transferred by the Policyholder to Units in the Fixed Account, and therefore the loan,

comprises an adjustment for earnings referable to the Assets represented by the surrendered Allocated Units (and used to purchase Units in the Fixed Account).

56. Where, during the eligible period of an eligible policy, a policyholder receives an amount of consideration in respect of the assignment of that eligible policy, that amount is assessable under subsection 26AH(6) as if it had been received as a bonus to the extent that, in the Commissioner's opinion, it is attributable to a bonus that has accrued or been declared, or a bonus that can reasonably be expected to accrue – subsections 26AH(9) and (12). Any consideration received by a Policyholder in respect of an assignment of their EIB during its eligible period will, for the purposes of subsection 26AH(6), be deemed pursuant to subsection 26AH(9) to have been received by the Policyholder as or by way of a bonus to the extent that the consideration received is attributable to a bonus.

57. Pursuant to subparagraph 26AH(7)(a)(i), subsection 26AH(6) does not apply to assess an amount received under an eligible policy where the amount is received in consequence of the death of the person on whose life the policy was effected. Any amount as, or by way of, a bonus received under an EIB (as a portion of the Death Benefit) in consequence of the death of the Relevant Life Assured is therefore not assessable under subsection 26AH(6).

Effect of increased premiums on eligible period

58. As an anti-avoidance measure, subsection 26AH(13) provides for a substituted date of commencement to apply if premiums increase by a certain amount from year to year. Where the premium payable under an eligible policy in relation to an assurance year exceeds by more than 25% the premium payable under the policy in the immediately preceding assurance year, the policy is deemed to have commenced at the beginning of the year in which the premium was increased. The effect of subsection 26AH(13) is to cause the 10-year eligible period in respect of an eligible policy to run from the commencement of that new period rather than from the date upon which the risk was first insured.

59. Where the Premium payable by a Policyholder in respect of an EIB in relation to an assurance year exceeds the Premium payable under that EIB in the immediately preceding assurance year by more than 25%, the 10-year eligible period in respect of the EIB is deemed by application of subsection 26AH(13) to have commenced at the beginning of the year in which the Premium was increased, rather than at the date of commencement of the period in respect of which the first Premium under the EIB was paid.

60. Where the Premium payable by a Policyholder in respect of an EIB in relation to each assurance year does not exceed the Premium payable under that EIB in the immediately preceding assurance year by more than 25%, the 10-year eligible period in respect of the EIB, for the purposes of the application of subsection 26AH(6), continues to run from the date of commencement of the period in respect of which the first Premium under the EIB was paid.

Capital gain or capital loss from payments under the executive investment bond disregarded

61. Under subsection 108-5(1) of the ITAA 1997, a CGT asset is any kind of property or a legal or equitable right that is not property. The contractual rights of a Policyholder and, as applicable, a Policyholder's nominated beneficiary or deceased estate under an

EIB, are legally enforceable rights and therefore a CGT asset according to the definition in subsection 108-5(1) of the ITAA 1997.

62. Where Quilter makes a payment of a Surrender Value or part surrender benefit in satisfaction of a Policyholder's contractual rights under an EIB, their ownership of those rights is discharged or satisfied. Similarly, where Quilter makes a payment of a Death Benefit in satisfaction of a Policyholder's, a nominated beneficiary's or a Policyholder's deceased estate's contractual rights under an EIB, as applicable, their ownership of those rights is discharged or satisfied. This discharge or satisfaction of the contractual rights gives rise to CGT event C2 (paragraph 104-25(1)(b) of the ITAA 1997).

63. The Policyholder, their nominated beneficiary or their deceased estate, as applicable, makes a capital gain from this CGT event if their capital proceeds from the ending of the ownership of their asset are more than the asset's cost base or, alternatively, a capital loss if those capital proceeds are less than the asset's reduced cost base (subsection 104-25(3) of the ITAA 1997).

64. Section 118-300 of the ITAA 1997 exempts certain capital gains and losses made in respect of a policy of insurance on the life of an individual. The meaning to be given to the expression 'policy of insurance on the life of an individual' includes, but is not limited to, life insurance policies within the common law meaning of that term. It can apply to other life insurance policies as defined in subsection 995-1(1) of the ITAA 1997 but only to the extent that those policies provide for a sum of money to be paid if an event happens that results in the death of an individual (Taxation Determination TD 2007/4 *Income tax: capital gains tax: is a 'policy of insurance on the life of an individual' in section 118-300 of the Income Tax Assessment Act 1997 limited to a life insurance policy within the common law meaning of that expression?*).

65. Table item 3 of subsection 118-300(1) of the ITAA 1997 provides that a capital gain or capital loss made from a CGT event happening in relation to a CGT asset that is an interest in rights under a policy of insurance on the life of an individual is disregarded where that CGT event happens to the original owner of the policy (other than the trustee of a complying superannuation entity).

66. As an entity to whom/which the EIB is first issued, a Policyholder referred to in paragraph 6(a) of this Product Ruling is regarded as an original owner of a policy of insurance on the life of an individual. Accordingly, that Policyholder is entitled under table item 3 of subsection 118-300(1) of the ITAA 1997 to disregard any capital gain or capital loss they make under section 104-25 of the ITAA 1997 from the receipt of a payment by Quilter of either a Surrender Value or part surrender benefit upon total or part surrender of the EIB, or (where the Policyholder is not a life assured) a Death Benefit.

67. Table item 4 of subsection 118-300(1) of the ITAA 1997 provides that a capital gain or capital loss made from a CGT event happening in relation to a CGT asset that is an interest in rights under a policy of insurance on the life of an individual is disregarded where that CGT event happens to an entity that acquired the interest in the policy for no consideration.

68. On the assignment of ownership of an EIB for no consideration to a Policyholder referred to in paragraph 6(b) of this Product Ruling, that Policyholder acquires an interest in the EIB for no consideration. A Policyholder referred to in paragraph 6(b) of this Product Ruling is therefore entitled under table item 4 of subsection 118-300(1) of the ITAA 1997 to disregard any capital gain or capital loss they make under section 104-25 of the ITAA 1997 from the receipt of a payment by Quilter of either a Surrender Value or part surrender benefit upon total or part surrender of the EIB, or (where the Policyholder is not a life assured) a Death Benefit.

69. On the death of a Policyholder who is the Relevant Life Assured, the Policyholder's nominated beneficiary or deceased estate, as applicable, acquires an interest in the EIB for no consideration. The beneficiary or the deceased estate, as applicable, is therefore entitled under table item 4 of subsection 118-300(1) of the ITAA 1997 to disregard any capital gain or capital loss they make under section 104-25 of the ITAA 1997 from the receipt of a payment of a Death Benefit by Quilter.

Part IVA – anti-avoidance

70. Provided that the scheme ruled on is entered into and carried out as disclosed in this Product Ruling, it is accepted that the scheme is an ordinary commercial transaction and Part IVA will not apply.

Status: **not legally binding**

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

IT 2346; TD 94/82; TD 2007/4

Legislative references:

- ITAA 1936 6(1)
- ITAA 1936 26AH
- ITAA 1936 26AH(1)
- ITAA 1936 26AH(4)
- ITAA 1936 26AH(5)
- ITAA 1936 26AH(6)
- ITAA 1936 26AH(7)(a)(i)
- ITAA 1936 26AH(8)
- ITAA 1936 26AH(8)(b)
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- ITAA 1936 26AH(12)
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- ITAA 1936 95(2)
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- ITAA 1936 Part IVA
- ITAA 1997 Pt 3-1
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- ITAA 1997 104-25(1)(b)
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- ITAA 1997 Div 775
- ITAA 1997 995-1(1)
- Life Insurance Act 1995 9
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ATO references

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