CR 2007/108 - Income tax: The National Mutual Life Association of Australasia Limited: application of section 26AH of the Income Tax Assessment Act 1936 to Guaranteed Investment Bonds and Personal Investment Bonds

Class Ruling

Income tax: The National Mutual Life Association of Australasia Limited: application of section 26AH of the *Income Tax Assessment Act 1936* to Guaranteed Investment Bonds and Personal Investment Bonds

Contents Para

This publication provides you with the following level of protection:

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

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are:

- section 26AH of the *Income Tax Assessment Act 1936* (ITAA 1936);
- subsection 26AH(1) of the ITAA 1936;
- subsection 26AH(6) of the ITAA 1936;
- subsection 26AH(13) of the ITAA 1936; and
- subsection 995-1(1) of the *Income Tax Assessment Act 1997* (ITAA 1997).

Class of entities

3. The class of entities to which this Ruling applies are the holders of a Guaranteed Investment Bond (GIB) policy and/or a Personal Investment Bond (PIB) policy as at 1 July 2007 (the 'policyholders') issued by The National Mutual Life Association of Australasia Limited (NMLA).

Qualifications

4. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.

5. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 13 to 26 of this Ruling.

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

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

Date of effect

8. This Ruling applies from 1 July 2007 to 30 June 2008. However, the Ruling continues to apply after 30 June 2008 to all entities within the specified class who entered into the specified scheme during the term of the Ruling.

9. The Ruling does 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 Ruling. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

10. If this Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

11. If this Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

12. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Scheme

13. The scheme that is the subject of this Ruling is described below. The description incorporates the following documents:

- Application for Class Ruling dated 20 June 2007 received from The National Mutual Life Association of Australasia Limited (NMLA);
- copy of a GIB Policy;
- copy of a PIB Policy; and
- further information supplied by NMLA to the Tax Office dated 22 August 2007.

14. NMLA is the issuer of the GIB and PIB. The GIB and PIB are single premium insurance bonds. Insurance bonds are life insurance policies under the *Life Insurance Act 1995* (Life Act) and are backed by investments in NMLA's statutory fund. The GIB and PIB are investment-linked policies.

15. The GIB was available from 1 June 1989. The PIB was available from 1 April 1990. Both the GIB and the PIB are now closed that is, they are not available to be purchased by new policyholders.

16. NMLA wishes to enhance the product features of both the GIB and PIB so that they are aligned with each other. It is proposed to do this by taking certain features of each product and enhancing the other product with that feature.

17. NMLA advises that the proposed enhancements will not detrimentally impact on policyholders.

18. The reasons for undertaking a rationalisation of the GIB and PIB are to:

- provide a better and more fully featured product for all policyholders;
- reduce the administrative complexity and risk associated with administering products with different product rules and features and thereby provide clients with a consistent and potentially higher level of service; and
- deliver cost savings to policyholders and shareholders, as part of a wider product rationalisation initiative.

19. NMLA does not propose to issue policyholders with a new policy. Policyholders will instead have their policies enhanced so that they reflect a common set of features. The focus of the changes is to align the GIB's features with the PIB's features and migrate the GIB policyholders to the PIB administrative system. To further reflect this enhancement, a common product name for both products is likely to be adopted.

20. The following changes are proposed to the GIB and the PIB.

Investment portfolios and 'switching' option

21. The PIB allows investment in one or more investment portfolios. These portfolios offer different investment characteristics, for example, asset allocations and the range of underlying investment managers. A PIB policyholder can allocate a portion of their funds in one or all of the investment portfolios available, subject to relevant published minimums. PIB policyholders can switch their funds from one or all of the portfolios they are invested in to any of the other portfolios available that is, the PIB contains a 'switching option'.

22. The PIB provides more investment options than the GIB. The PIB offers the choice of the following investment portfolios:

(a) Guaranteed;

(b) Managed;

(c) International;

(d) Property based;

(e) Cash;

(f) Mortgage based;

(g) Matched;

(h) Secure;

(i) Australian equities;

(j) Australian fixed interest;

(k) MM Growth;

(l) MM Secure; and

(m) MM Balanced.

23. The GIB does not contain an option to invest in more than one investment portfolio. The investment premium is invested in an investment account in the GIB Guaranteed Portfolio. The major change to the GIB is to add the ability to choose to invest in one or more of the above listed investment portfolios and the ability to switch between those portfolios. If a GIB policyholder elects to switch to a portfolio(s) other than the Guaranteed Portfolio they will lose the benefit of the guarantee and be subject to market fluctuations in the same way as the PIB policyholders.

24. GIB policyholders may switch assets between portfolios at any time. A minimum amount (currently $1,000) must be switched from one portfolio to another. A small charge will be made for switching. At least $500 must be paid into each chosen investment portfolio. Minimum balances are required to be maintained after switching. These changes to the GIB will make its operation consistent with that of the PIB.

Exit and entry fee structure

25. The PIB operates on an entry fee basis. This means that fees are deducted from premiums. In contrast, the GIB adopts an exit fee approach. The GIB will change from an exit fee structure to an entry fee structure. A number of the proposed changes to certain clauses in the GIB policy are required in order to reflect the shift from an exit fee to an entry fee product. NMLA advises that the reason for the change is to reduce administrative complexity and that GIB policyholders will not be disadvantaged by the change.

Minimum policy investment

26. In relation to the PIB, the only proposed change is to decrease the minimum policy investment to $3,000. This will align the minimum policy investment amount for the PIB with the equivalent minimum policy investment amount for the GIB.

Other

27. In addition, there are a series of minor technical amendments that are not material to, and do not impact upon, the outcome in this Ruling.

Assumptions

28. This Ruling is made on the basis that the premium paid by a policyholder under the GIB and PIB does not exceed by more than 25% the amount of the premium payable under the GIB and PIB in relation to the immediately preceding insurance year, with the result that subsection 26AH(13) of the ITAA 1936 will not operate to recommence the date of commencement of risk.

Ruling

Date of commencement of risk does not recommence for policyholders

29. When the enhancements to both the GIB and the PIB are made the date of commencement of risk under the policies, for the purposes of section 26AH of the ITAA 1936, will not recommence for policyholders.

Commissioner of Taxation
21 November 2007

Appendix 1 – Explanation

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.

30. Section 26AH of the ITAA 1936 provides that a taxpayer's assessable income shall include bonuses, and some other amounts in the nature of bonuses, received under a relevant life assurance policy (an 'eligible policy') during a specified period (the 'eligible period').

Eligible policy

31. Subsection 26AH(1) of the ITAA 1936 defines an eligible policy as 'a life assurance policy in relation to which the date of commencement of risk is after 27 August 1982, other than a funeral policy…'. A life assurance policy is defined in subsection 6(1) of the ITAA 1936 as having the meaning given to 'life insurance policy' by the ITAA 1997. Subsection 995-1(1) of the ITAA 1997 defines a life insurance policy as having the meaning given to 'life policy' in the Life Act.

32. Section 9 of the Life Act defines a life policy. Specifically, paragraph 9(1)(g) of the Life Act states that a contract (whether or not it is a contract of insurance) that constitutes an investment-linked contract is a life policy. An investment-linked policy is described in paragraph 5 of Taxation Ruling IT 2346 Income tax: bonuses paid on certain life assurance policies – section 26AH – interpretation and operation as:

> 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.

33. The GIB and PIB are contracts which provide a death benefit and an investment account which is linked to the performance of a specific investment portfolio. Accordingly the GIB and PIB are investment-linked contracts. As such they qualify as life policies under section 9 of the Life Act and will accordingly satisfy the definition of life assurance policy for the purposes of section 26AH of the ITAA 1936.

34. The second element in the definition of eligible policy is that the date of commencement of risk must be after 27 August 1982. The 'date of commencement of risk' in relation to an eligible policy is defined in subsection 26AH(1) of the ITAA 1936 as 'the date of commencement of the period in respect of which the first or only premium paid under the policy was paid or, if the first or only premium was not paid in respect of a period, the date on which that premium was paid'.

35. The earliest dates with respect to which the first premium was paid in respect of a particular period and the date on which that premium was paid for the GIB and the PIB are 1 June 1989 and 1 April 1990 respectively. As these dates occur after 27 August 1982, the date of commencement of risk for both the GIB and the PIB is after 27 August 1982.

36. Accordingly both the GIB and PIB are 'eligible policies' for the purposes of section 26AH of the ITAA 1936.

Eligible period

37. Subsection 26AH(1) of the ITAA 1936 defines the 'eligible period' as the period of 10 years commencing on the date of commencement of risk of the policy.

38. Under subsection 26AH(6) of the ITAA 1936, for an eligible policy taken out after 7 December 1983 (such as the GIB and PIB), amounts received as or by way of bonuses are assessable in full if received in the first eight years after the date of commencement of risk of the policy, and as to two-thirds if the amount is received during the ninth year of the policy and as to one-third if received in the tenth year after that date. Amounts received by way of bonuses under an eligible policy taken out after 7 December 1983 after the tenth year are not included in a policyholder's assessable income.

39. The taxation treatment of the bonuses depends on the date of commencement of risk, rather than the date on which the policy is taken out. Certain variations in the terms of a policy can potentially create a new contract which is so inconsistent with the original contract that the original contract is extinguished; refer to paragraph 2 of 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? This could have the effect of recommencing the eligible period in respect of the policy.

Recommencement of the date of commencement of risk

40. Whether variations to an eligible policy create a new eligible policy is a question of fact. Where the conditions attaching to an eligible policy are merely varied the rearrangement of the policy conditions does not give rise to a new eligible policy and, accordingly, the date of commencement of risk will not recommence. This is in contrast to a situation where a contract is discharged that is, where a policy is surrendered or cancelled and holders are issued with a new policy. For example, if the sum insured is increased or there is a change in the term of the policy, this of itself will not give rise to a new eligible policy; refer to paragraph 17 of IT 2346. However, an increase in the amount of premiums payable in the policy, while not giving rise to a new eligible policy, could have the effect of recommencing the eligible period in respect of the policy under subsection 26AH(13) of the ITAA 1936.

41. As discussed above, it is assumed that subsection 26AH(13) of the ITAA 1936 will not apply to the policyholders, on the assumption that a policyholder does not pay a premium under the GIB or PIB that exceeds by more than 25% the amount of the premium payable under the GIB and PIB in relation to the immediately preceding insurance year.

42. Paragraph 3 of TD 94/82 states:

> … If the original contract contains a switching clause or it if contains a variation clause and the contract is varied to add a switching clause, we accept that if the policy holders has exercised the switching option, there has been a mere variation in the contract. However, the absence of a switching clause or of a variation provision does not prevent the addition of a switching clause and the subsequent exercise of the switching option from being considered as a mere variation of the contract for section 26AH purposes.

43. The changes to the GIB fall within the situation outlined in TD 94/82 that is, a switching clause is being added to the terms of the contract. The addition of a switching option into the terms of the GIB will be considered a mere variation of the contract for section 26AH of the ITAA 1936 purposes with the result that the date of commencement of risk will not recommence.

44. In contrast, if the policyholder is only able to change his or her preferred investment options by surrendering the existing policy and entering into a new policy, a new eligible period would commence for the purposes of subsection 26AH(6) of the ITAA 1936. That would also be the case if, for example, the policy certificate was cancelled and a replacement policy was issued, or if existing policies were converted or consolidated into one, or if the underlying risk insured against was changed; refer to paragraph 4 of TD 94/82. In this instance, neither the GIB nor PIB will be cancelled or surrendered by policyholders. Nor is it proposed to issue the policyholders with new policies.

45. On the basis that the changes to the GIB and PIB are mere enhancements to the terms of the policy and taking into account the fact that the addition of a switching option is considered to be a mere variation of the contract, it is considered that the amendments to the GIB and PIB as set out in the description of the scheme above, will not trigger a recommencement of the eligible period.

Appendix 2 – Detailed contents list

46. The following is a detailed contents list for this Ruling

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

IT 2346; TD 94/82

Subject references:

- date of commencement of risk
- eligible period
- eligible policy
- investment linked policies
- life assurance bonuses
- life insurance policies
- switching

Legislative references:

- ITAA 1936 6(1)
- ITAA 1936 26AH
- ITAA 1936 26AH(1)
- ITAA 1936 26AH(6)
- ITAA 1936 26AH(13)
- ITAA 1997 995-1(1)
- Life Insurance Act 1995
- Life Insurance Act 1995 9
- Life Insurance Act 1995 9(1)(g)
- TAA 1953
- TAA 1953 Sch 1 357-75(1)
- Copyright Act 1968

ATO references

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