


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?

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Taxation Determination

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?

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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.

Ruling

1. No. The expression 'policy of insurance on the life of an individual' in section 118-300 of the *Income Tax Assessment Act 1997*¹ (ITAA 1997) includes, but is not limited to, life insurance policies within the common law meaning of that term. The expression also includes other life insurance policies as defined in subsection 995-1(1) 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.

2. A 'policy of insurance on the life of an individual' also includes a life insurance policy to the extent that it provides for the payment of a 'terminal illness benefit'. Essentially, a terminal illness benefit is a pre-payment of a death benefit and in determining whether it is covered by items 3 to 6 of the table in subsection 118-300(1) it is irrelevant that it is paid before death rather than after death.²

¹ Unless otherwise specified all legislative references are to the ITAA 1997.

² Under Australian insurance industry standards, a 'terminal illness benefit' is one which is payable upon the diagnosis of an illness which will result in the death of the insured within 12 months regardless of any treatment they may receive.

Examples**Example 1**

3. *Nellie was the original beneficial owner of a trauma policy. Under the policy Nellie was to be paid a sum in the event her husband Noel suffered one of a number of 'traumas'. Noel suffered a heart attack and died. Nellie received a payment under the policy.*

4. *On receipt of the payments under the policy, CGT event C2 in section 104-25 happened because her rights under the policy ended. Any capital gain or loss that Nellie makes as a result of CGT event C2 happening is disregarded under section 118-300 because the payment under the policy was made as a result of Noel's death.*

Example 2

5. *Assume the facts in Example 1 but change them so that Noel did not die. The payment under the insurance policy is not exempt under section 118-300 because it was paid in respect of Noel's suffering a heart attack not because of his death. [Note however that the payment will be exempt under paragraph 118-37(1)(b) which exempts compensation received for an illness suffered by a relative.]*

Example 3

6. *Frances was the original beneficial owner of a term life insurance policy which provided for the payment of a terminal illness benefit. Frances was diagnosed with a terminal illness and advised by her doctor that she could expect to live for less than 12 months. One month after receiving this diagnosis, Frances received a payment under her insurance policy.*

7. *On receipt of the payment under the policy, CGT event C2 in section 104-25 happened. Any capital gain or loss that Frances makes as a result of CGT event C2 happening is disregarded under section 118-300. The exemption applies because the payment was made on the happening of an event that was contingent on the duration of Frances' life. The event was the diagnosed expectation of her death within a 12 month period.*

Example 4

8. *Jesse was the original beneficial owner of an endowment life insurance policy. Jesse received a lump sum payment under the policy when he attained 60 years of age.*

9. *On receipt of the payment under the policy, CGT event C2 in section 104-25 happened. Any capital gain or loss that Jesse makes as a result of CGT event C2 happening is disregarded under section 118-300 because the payment was made on the happening of an event that was contingent on the duration of human life.*

Example 5

10. *Arthur purchased a funeral policy from ABC Friendly Society with the intention of providing for his future funeral expenses. When Arthur died his executor instructed ABC Friendly Society to pay the proceeds from the policy to XYZ Funeral Directors.*

11. *Any capital gain or loss from CGT event C2 happening to the funeral policy is disregarded under section 118-300 of the ITAA 1997, because the payment under the funeral policy was contingent on the duration of human life. [Note while any realised growth on the policy is not subject to capital gains tax it may be subject to separate assessment – see subsection 26AH(7) of the Income Tax Assessment Act 1936 (ITAA 1936) or section 15-55 of the ITAA 1997].*

Date of effect

12. This Determination applies to years commencing both before and after its date of issue. However there are two exceptions. The first exception is that the Determination will have only a prospective date of effect to the extent that the position in this final Determination differs from its draft (TD 2006/D36). TD 2006/D36 indicated that a policy of insurance on the life of an individual could include a general policy of insurance (for example, a sickness and accident policy) to the extent it provided for a payment to be made on the death of an individual. The second exception is that the Determination 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 Determination (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation28 March 2007

Appendix 1 – Explanation

❶ *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.*

Explanation

13. Section 118-300 exempts certain capital gains and losses made from CGT events happening to insurance policies. In particular, items 3 to 6 of the table in subsection 118-300(1) exempt certain capital gains and losses made in respect of a 'policy of insurance on the life of an individual'. This expression is not defined in the ITAA 1997.

ITAA 1997 meaning of 'life insurance policy'

14. The expression 'life insurance policy' is defined in subsection 995-1(1) of the ITAA 1997 principally by reference to the definition of life policy in the *Life Insurance Act 1995* but also includes other items such as sinking fund policies. The definition of 'life insurance policy' in the ITAA 1997 includes a range of policies that would not come within the common law meaning of that term.

15. It is clear that the legislature did not intend the expression 'a policy of insurance on the life of an individual' to have the same meaning as 'life insurance policy'. Items 3 to 6 of subsection 118-300(1) were amended to replace the defined term 'life insurance policy' with the expression 'policy of insurance on the life of an individual'. The Revised Explanatory Memorandum to the New Business Tax System (Miscellaneous) Bill (No. 2) 2000 noted:

the amendments ensure that ... sections 118-300 and 152-20 are restricted to those policies that qualify as life insurance policies under the current law, that is, policies of insurance that are taken out on the life of an individual.

16. Thus, for example, although an investment policy which does not make the death of a person an event triggering a payment may be a life insurance policy for other purposes of the ITAA 1997, it is not a 'policy of insurance on the life of an individual' for the purposes of section 118-300.

Common law meaning of 'life insurance policy'

17. It has been suggested that the expression 'policy of insurance on the life of an individual' must take on the common law meaning of the words 'life insurance policy'.

18. The courts have considered the common law meaning of 'life insurance policy' in a number of cases: see for example *National Mutual Life Association of Australia v. FCT* (1959) 102 CLR 29; (1959) 11 ATD 523; (1959) 7 AITR 368 (*National Mutual*) and more recently *AMP Life Limited v. Commissioner of State Revenue* (2003) 53 ATR 54; 2003 ATC 4526. They have concluded that life insurance policies (whether term, whole of life or endowment³) are those where one party agrees to pay a given sum upon the happening of a particular event (contingent upon the duration of human life) in consideration of the immediate payment of a smaller sum or certain equivalent periodical payments by another.

³ A term policy is an insurance limited for a specified period, the sum insured being payable if the life insured dies within the period, but nothing being payable if he survives. A whole of life policy is one in which the sum insured is payable at death. An endowment policy provides for the payment of the sum insured if the life insured is alive at some future date called the maturity date or upon the earlier death of the life insured.

19. In relation to the requirement that the event giving rise to a payment be one that is contingent on the duration of human life, the courts have held that it is not enough that a policy may provide for a payment to be made on death.
20. Windeyer J in *National Mutual* stated at page 45:
Marine, fire, burglary, personal accident, motor vehicle and other miscellaneous insurances indemnify the insured against loss from events which may or may not occur. Life insurance on the other hand is related to a contingency, death, which must occur. It is not a risk, it is a certainty; the only uncertainty is when it will occur.
21. While noting that insurances against accidental death in some way resemble life policies Windeyer J observed that ordinary accident policies providing for payment on accidental death have been held not to be life policies for the provisions in bankruptcy and similar legislation by which life policies are protected. He continued at page 47:
Accident and sickness policies also differ from most life insurances in that they are ordinarily only annual contracts... Even when an accident or sickness policy is renewable at the option of the insured, it differs markedly from a life policy in that it has no surrender value, each annual premium being in effect the consideration for the cover for the ensuing year.
22. On this view, a trauma policy under which an amount is paid on diagnosis of a specific disease or trauma would not constitute a policy of insurance even if it includes a death benefit. This is because the policy is based on risk – death from a specific disease.
23. Where a common law life insurance policy is combined with additional benefits the courts have been prepared to dissect the policies into their life insurance and other components to work out the tax consequences in respect of each component. Thus, for example, in *National Mutual* the Court held that premiums paid under a combined policy were exempt under section 111 of the ITAA 1936 (which exempted premiums received in respect of policies of life assurance) to the extent they represented premiums for life insurance but not to the extent that they related to permanent disablement.

Tax Office approach

24. The Commissioner takes the view that the expression 'policy of insurance on the life of an individual' is not confined to the common law meaning of that term. The expression also includes a life insurance policy (as defined in subsection 995-1(1)) to the extent it provides for a payment to be made if an event happens that results in the death of an individual.
25. There is no policy reason why the exemption in section 118-300 should exclude situations where death of the insured happens because of a particular illness.
26. This means, for example, a payment under a trauma policy may be exempt under section 118-300 if it is paid in respect of the death (rather than illness) of the insured and the other conditions in the provision are satisfied. A payment under such a policy in respect of an illness will not be exempt under section 118-300, although it may be exempt under section 118-37.
27. Note 1: Payments under a sickness and accident policy relating to the death or personal injury of an individual may be exempt under section 118-37.
28. Note 2: Although a payment may be exempt from capital gains tax, it may be assessable as ordinary or statutory income under sections 6-5 or 6-10.

References

Previous draft:

TD 2006/D36

- ITAA 1997 118-37
- ITAA 1997 118-37(1)(b)
- ITAA 1997 118-300
- ITAA 1997 118-300(1)
- ITAA 1997 152-20
- ITAA 1997 995-1(1)
- Life Insurance Act 1995

Related Rulings/Determinations:

TR 2006/10
TD 14

Subject references:

- capital gains tax
- CGT events
- CGT events C1-C3 - end of a CGT asset
- CGT exemptions
- life insurance policies

Case references:

- AMP Life Limited v. Commissioner of State Revenue (2003) 53 ATR 54; 2003 ATC 4526
- National Mutual Life Association of Australia v. FCT (1959) 102 CLR 29; (1959) 11 ATD 523; (1959) 7 AITR 368

Legislative references:

- TAA 1953
- ITAA 1936 111
- ITAA 1936 26AH(7)
- ITAA 1997 6-5
- ITAA 1997 6-10
- ITAA 1997 15-55
- ITAA 1997 104-25

Other references:

- Revised Explanatory Memorandum to the New Business Tax System (Miscellaneous) Bill (No. 2) 2000

ATO references

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Income Tax ~ Capital Gains Tax ~ CGT event - general
Income Tax ~ Capital Gains Tax ~ exemptions other than main residence