TD 2006/D36 - 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?

This document has been finalised by TD 2007/4.

Draft 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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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* (ITAA 1997) includes, but is not limited to, life insurance policies to the extent they are within the common law meaning of that term. The expression also includes other policies to the extent that they 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 an insurance policy to the extent that it provides for the payment of a 'terminal illness benefit'. 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. 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) of the ITAA 1997 it is irrelevant that it is paid before death rather than after death.

Examples

Example 1

3. *Nellie was the original beneficial owner of an accident policy. Under the policy Nellie was to be paid a sum in the event of the death or injury of her husband Noel. Noel was involved in a car accident and died as a result of the injuries he sustained. Nellie received a payment under the policy in the 2005-2006 income year.*

4. *On receipt of the payments under the policy, CGT event C2 in section 104-25 of the ITAA 1997 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 of the ITAA 1997 because the payment under the continuous disability policy was contingent on the duration of Noel's life.*

Example 2

5. *Assume the facts in Example 1 but change them so that Noel did not die in the accident but sustained serious injuries. The payment under the insurance policy is not exempt under section 118-300 of the ITAA 1997 because it was contingent on Noel being injured not on the duration of his life. [Note however that the payment will be exempt under paragraph 118-37(1)(b) of the ITAA 1997 which exempts compensation received for an injury suffered by a relative.]*

Example 3

6. *Frances was the original beneficial owner of a 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 of the ITAA 1997 happened.*

8. *Any capital gain or loss that Frances makes as a result of CGT event C2 happening is disregarded under section 118-300 of the ITAA 1997. 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 professionally diagnosed expectation of her death within a 12 month period.*

Example 4

9. *Jesse was the original beneficial owner of an endowment life insurance policy under which he was to receive a lump sum on the attainment of age 60. Jesse turned 60 in the 2005-2006 income year and received a payment under the policy.*

10. *On receipt of the payment under the policy, CGT event C2 in section 104-25 of the ITAA 1997 happened.*

11. *Any capital gain or loss that Jesse makes as a result of CGT event C2 happening is disregarded under section 118-300 of the ITAA 1997 because the payment was made on the happening of an event that was contingent on the duration of human life.*

Date of effect

12. When the final Determination is issued, it is proposed to apply to years commencing 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.

Commissioner of Taxation
21 June 2006

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.

Explanation

13. Section 118-300 of the ITAA 1997 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.

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) of the ITAA 1997 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.

Common law meaning of life insurance policy

16. 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'.

17. 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 endowment[1]) 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.

[1] 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 at some future date called the maturity date or earlier death.

18. 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.

19. 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.

20. While noting that insurances against accidental death in some way resemble life policies he 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.

21. However, where a 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 *Income Tax Assessment Act 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

22. Given the different form of words used in section 118-300 of the ITAA 1997,[2] 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. It is also not the same as a life insurance policy as defined for the purposes of the ITAA 1997.

23. There is no policy reason why the exemption in section 118-300 of the ITAA 1997 should exclude situations where death of the insured happens by accident or because of a particular illness. Therefore, the Commissioner considers the expression includes an insurance policy to the extent it provides for a payment to be made if an event happens that results in the death of an individual.

24. This means, for example, a payment under a trauma policy may be exempt under section 118-300 of the ITAA 1997 if it is paid in respect of the death (rather than injury) of the insured and the other conditions in the provision are satisfied. A payment under such a policy in respect of a disability will not be exempt under section 118-300.[3]

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[2] Compared with the expression ‘life insurance policy’.
[3] Such a payment may be exempt under section 118-37 of the ITAA 1997.

Appendix 2 – Your comments

25. We invite you to comment on this draft Taxation Determination. Please forward your comments to the contact officer by the due date. (Note: The Tax Office prepares a compendium of comments for the consideration of the relevant Rulings Panel. The Tax Office may use a sanitised version (names and identifying information removed) of the compendium in providing its responses to persons providing comments. Please advise if you do not want your comments included in a sanitised compendium.)

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References

Previous draft:

Not previously issued as a draft

Subject references:

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

Legislative references:

- ITAA 1936 111
- ITAA 1997 104-25
- 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

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

Other references:

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

ATO references

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