


# ***TA 2003/2 - Investment into Foreign Life Insurance Policies***

 This cover sheet is provided for information only. It does not form part of *TA 2003/2 - Investment into Foreign Life Insurance Policies*



# Taxpayer Alert

**TA 2003/2**

**The Taxation Office view on this arrangement is set out in TR 2004/3.**

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**FOI status: may be released**

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*Taxpayer Alerts are intended to be an "early warning" of significant new and emerging tax planning issues or arrangements that the ATO has under risk assessment.*

*Taxpayer Alerts will provide information that is in the interests of an open tax administration to taxpayers. Taxpayer Alerts are written principally for taxpayers and their advisers and they also serve to inform ATO officers of new and emerging tax planning issues. Not all potential tax planning issues that the ATO has under risk assessment will be the subject of a Taxpayer Alert, and some arrangements that are the subject of a Taxpayer Alert may on further examination be found not to be of concern to the ATO.*

*Taxpayer Alerts will give the title of the issue (which may be a scheme, arrangement or particular transaction), briefly describe the issue and will highlight the features which the ATO considers give rise to taxation issues. These issues will generally require more detailed analysis to provide an ATO view to taxpayers.*

*The developers and marketers of an arrangement which is the subject of a Taxpayer Alert should provide the full facts of the arrangement to the ATO to enable the ATO to finalise its view.*

*Taxpayers who have entered into or are contemplating entering into an arrangement similar to that described in this Taxpayer Alert can seek a formal determination of the ATO's position through a Private Ruling. Such taxpayers might obtain their own advice and/or contact the ATO officer named in the Alert.*

*This Taxpayer Alert is issued under the authority of the Commissioner.*

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**TITLE:            Investment into Foreign Life Insurance Policies**

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This Taxpayer Alert describes an arrangement which has as one of its features the purchase of a life insurance policy from a tax haven based life insurance company. An investor borrows money to indirectly invest in the life insurance policy, via a trust and a company. The investor seeks to earn tax-free income outside Australia on the investment and income tax deductions for interest payments on the borrowings. It would seem that the only economic benefit achievable by an investor entering into this arrangement is through the claimed tax savings.

## **DESCRIPTION**

The alert applies to arrangements having the following features:

1. A investor obtains for a small premium, for example \$1,000, a life insurance policy from a tax haven based life insurance company. The policy can be surrendered at any time.
2. At the same time, the investor subscribes for units in an Australian resident unit trust to the value of, for example, \$100,000. Payment for the units may be funded by a loan from a tax haven based bank related to the life insurance company at an interest rate of, for example, 10%.

3. The unit trust invests the funds from the unit subscription into an Australian resident company.
4. That company enters into an Investment Agreement with the life insurance company to invest the \$100,000 into the same life insurance policy purchased by the investor for a guaranteed return which approximates the interest rate on the investor's loan, 10%. Under the terms of the Investment Agreement the company will receive a return of, for example, 3%. The balance of the income, being 7%, will accrue on the life insurance policy for the benefit of the investor.
5. The company pays this return of 3% as franked dividends to the unit trust. In turn any profit the trust makes after deducting various fees and expenses will be distributed to the investor.
6. The investor receiving a distribution of income claims a rebate for the franking credits and deductions for the interest payments made on the borrowing.
7. After 10 years the company surrenders its interest in the life insurance policy and receives its invested amount of \$100,000. The company is liquidated with a capital return to the unit trust of \$100,000 whose units in turn will be redeemed allowing the investor to use these funds to pay out the borrowing.
8. At the time of this surrender by the company, the amounts that have accrued on the life insurance policy will be paid to the investor.

## **FEATURES WHICH THE ATO CONSIDERS GIVE RISE TO TAXATION ISSUES**

The ATO considers that the arrangement outlined above gives rise to taxation issues which include:

- (a) The application of the Foreign Investment Fund ('FIF') measures contained in Part XI of the *Income Tax Assessment Act 1936* (the ITAA 1936). An Australian resident who has invested in a offshore life insurance policy with an investment component will be subject to the FIF measures (section 482 of the ITAA 1936). These provisions are an accruals system of taxing foreign source income such that an amount of income will be attributed each year to the investor.
- (b) The application of section 26AH of the ITAA 1936 and the availability of the rebate in section 160AAB of the ITAA 1936.
- (c) Whether the interest expenses on funds borrowed to acquire units in the trust are deductible.
- (d) Whether the general anti-avoidance provisions of Part IVA of the ITAA 1936 apply having regard to the appearance of round robin funding or a circular movement of funds and guaranteed returns.

***The Australian Taxation Office is examining these and similar arrangements.***

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*subject references:* Foreign Life Insurance Policies

*related taxation rulings:*

*legislative references:* ITAA 1936 Section 26AH  
ITAA 1936 Section 160AAB  
ITAA 1936 Section 482

ITAA 1936 Part IVA  
ITAA 1936 Part XI

*related taxpayer alerts:*

*related practice statements:* PS 2001/15 - Taxpayer Alerts

*related media releases:*

*file references:*

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Date issued:	
Authorised by:	<b>Mr Kevin Fitzpatrick First Assistant Commissioner</b>
Contact Officer:	<b>Ms Alison Morris</b>
Business Line:	<b>Large Business &amp; Internationals</b>
Section:	<b>International Strategy &amp; Operations - Taxation of Residents Practice</b>
Phone:	<b>(02) 9374 8340</b>

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