



ATO Ruling 1/3/19

Notice of private ruling 1051489729469

This ruling applies to:

Client name: The trustee for the Aussie TEP Fund

TFN: XXX XXX XXX

Edited version of your private ruling Authorisation Number: 1051489729469

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Ruling

Subject: Traded Endowment Policies

Question 1

Is the unit trust a public trading trust pursuant to section 102R of the *Income Tax Assessment Act 1936* (ITAA 1936)?

Answer

No

Question 2

Are the Traded Endowment Policies (TEPs) eligible policies for the purposes section 26AH of the ITAA 1936?

Answer

Yes

Question 3

Will the beneficiaries or the trustee of the unit trust, as applicable, be entitled to a rebate of tax under section 160AAB of the ITAA 1936 equal to the statutory percentage of any rebatable amount?

Answer

Yes

Question 4

Will the exemption in section 118-300 of the *Income Tax Assessment Act 1997* (ITAA 1997) apply to disregard any capital gains or losses made in relation to the TEPs by the unit trust?

Answer

Yes

This ruling applies for the following periods:

Income year ending 30 June 2019 Income year ending 30 June 2020 Income year ending 30 June 2021

The scheme commenced on:

6 February 2019

Relevant facts and circumstances

The trust is an Australian unit trust. It offers Investors the opportunity to invest in units of the trust. The trustee of the unit trust invests in TEPs.

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The unit trust is an unregistered managed investment scheme which pools Investors' money and invests in a portfolio of Australian TEPs which have an asset value and a fixed maturity date. The unit trust will hold those TEPs until maturity. Once the TEP is purchased the following occurs:

statutory title is vested in the Trustee;
the issuing Life Company allocates its bonuses to the TEP annually;
there are no fees/expenses payable to the Life Company in respect of a TEP other than the

annual premium;
six weeks before the TEP's maturity, the Manager notifies the Life Company where to pay the

maturity amount; and
the maturity amount is paid by the Life Company on the maturity date.

The TEP is a zero coupon investment and the maturity value of the TEP will include the total of the Sum Insured, Accumulated Reversionary Bonuses (constituting annual bonuses on the TEP credited each year) and a Terminal Bonus (constituting the bonus applied to a TEP on the earlier of death of the original life insured or the fixed maturity date of the policy).

Assumptions

1. Investors in the unit trust are residents of Australia for tax purposes.
2. None of the TEPs are issued by a life assurance company the whole of the income of which is

exempt from tax.
3. The only assets of the unit trust are TEPs and cash deposits (in the form of bank accounts).

Relevant legislative provisions

Income Tax Assessment Act 1936 subsection 6(1) *Income Tax Assessment Act 1936* section 26AH *Income Tax Assessment Act 1936* subsection 26AH(1) *Income Tax Assessment Act 1936* subsection 26AH(6) *Income Tax Assessment Act 1936* section 97

Income Tax Assessment Act 1936 section 98
Income Tax Assessment Act 1936 section 98A
Income Tax Assessment Act 1936 section 99
Income Tax Assessment Act 1936 section 99A
Income Tax Assessment Act 1936 section 100
Income Tax Assessment Act 1936 Division 6C
Income Tax Assessment Act 1936 section 102M
Income Tax Assessment Act 1936 section 102N
Income Tax Assessment Act 1936 section 102R
Income Tax Assessment Act 1936 subparagraph 102R(1)(b)(ii) *Income Tax Assessment Act 1936* section 160AAB

Income Tax Assessment Act 1936 subsection 160AAB(3) *Income Tax Assessment Act 1936* subsection 160AAB(4) *Income Tax Assessment Act 1936* subsection 160AAB(5) *Income Tax Assessment Act 1997* section 118-300 *Income Tax Assessment Act 1997* subsection 118-300(1) *Income Tax Assessment Act 1997* subsection 995-1(1) *Life Insurance Act 1995* section 9

Life Insurance Act 1995 paragraph 9(1)(a) *Life Insurance Act 1995* paragraph 9(1)(g) *Life Insurance Act 1995* section 200

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Reasons for decision

Question 1

Summary

The unit trust is not a public trading trust as defined in section 102R of the ITAA 1936 as it is not a trading trust.

Detailed reasoning

The definition of 'public trading trust' for the purpose of Division 6C of the ITAA 1936 is set out in section 102R of the ITAA 1936. For the income years commencing 1 July 1988 or later, a unit trust is a public trading trust in relation to a year of income where:

(i) the unit trust is a public unit trust in relation to the relevant year of income; (ii) the unit trust is a trading trust in relation to the relevant year of income; (iii) either of the following conditions is satisfied:

(A) the unit trust is a resident unit trust in relation to the relevant year of income;

(B) the unit trust was a public trading trust in relation to a year of income preceding the relevant year of income.

In order to meet the requirement of a 'trading trust' under subparagraph 102R(1)(b)(ii) of the ITAA 1936, the definition of 'trading trust', as defined in section 102N of the ITAA 1936, is required to be satisfied.

A unit trust is a 'trading trust' in relation to a year of income if, at any time during the year of income, the trustee:

(a) carried on a trading business; or

(b) controlled, or was able to control, directly or indirectly, the affairs or operations of another person in respect of the carrying on by that other person of a trading business.

Section 102N of the ITAA 1936 refers to the term 'trading business'. This is defined in section 102M of the ITAA 1936 to mean 'a business that does not consist wholly of eligible investment business.' The term 'eligible investment business' is defined in section 102M of the ITAA 1936 to include, among other activities, investing or trading in life assurance policies and investing or trading in loans (including deposits with a bank or other financial institution).

As the unit trust's activities will consist wholly of investing in life assurance policies (as defined below in response to question 2 of this ruling) and investing any surplus funds on deposit with a bank or other financial institution, the unit trust will not be carrying on a trading business, nor will it be controlling the affairs or operations of another person in respect of the carrying on by that other person of a trading business.

The unit trust will therefore not, for the purposes of Division 6C of the ITAA 1936, be either a trading trust pursuant to section 102N of the ITAA 1936 or a public trading trust pursuant to section 102R of the ITAA 1936.

Question 2

Summary

The TEPs are eligible policies as defined in subsection 26AH(1) of the ITAA 1936.

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Detailed reasoning

Section 26AH applies to eligible policies as defined in subsection 26AH(1) of the ITAA 1936. An 'eligible policy' in respect of which section 26AH may apply is defined 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'.

The term '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. 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*.

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: paragraphs 9(1)(a) and (g) of the *Life Insurance Act 1995*.

The TEPs that the unit trust will purchase will be eligible policies for the purposes of section 26AH as:

they will have a date of commencement of risk which is after 27 August 1982;

they are not a 'funeral policy', as defined in subsection 995-1(1) of the ITAA 1997, and

they are life assurance policies by virtue of constituting a life policy pursuant to section 9 of the *Life Insurance Act 1995*.

Question 3

Summary

An Investor (as a beneficiary of the unit trust) and/or or the Trustee of the unit trust, as applicable, will be entitled to a rebate of tax under section 160AAB of the ITAA 1936 equal to the statutory percentage of the relevant rebatable amount in the circumstances set out in subsections 160AAB(3), (4) or (5) of the ITAA 1936.

Detailed reasoning

The bonuses on an endowment policy are considered to be reversionary bonuses as they are not actually paid out to the policy owner but are reinvested to be part of the lump sum which is paid on maturity, forfeiture or surrender of the policy.

Reversionary bonuses are fully assessable under subsection 26AH(6) of the ITAA 1936 if the endowment policy (where it is an eligible policy) is cashed in during the first eight years of the eligible period, two-thirds assessable if cashed in the ninth year, and one-third assessable if cashed in during the tenth year. This is the ten year period (the 'eligible period') commencing on the date of the commencement of risk, being the period in respect of which the first premium paid under the policy was paid for or, if the first premium was not paid in respect of a period, the date on which the first premium was paid. If the policy matures or is otherwise terminated after ten years, section 26AH of the ITAA 1936 excludes reversionary bonuses from being assessable.

An amount included in assessable income under section 26AH of the ITAA 1936 in relation to an eligible policy issued by a life assurance company is, for the purposes of section 160AAB of the ITAA 1936, referred to as an 'eligible 26AH amount'.

Subsection 160AAB(3) of the ITAA 1936 provides that where a beneficiary (otherwise than in the capacity of trustee of another trust estate) is assessed under section 97, 98A or 100 of the ITAA 1936 and the whole or part of the amount included as assessable income (referred to as the 'rebatale amount') is attributable to an eligible 26AH amount included in the assessable income of

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the trust estate, the beneficiary is entitled to a rebate of tax equal to the statutory percentage of the rebatale amount.

Subsection 160AAB(4) of the ITAA 1936 provides that where a trustee of a trust estate is assessed and liable to pay tax pursuant to section 98 in respect of a share of the net income of the trust estate and the whole or part of that share (referred to as the 'rebatale amount') is attributable to an eligible 26AH amount included in the assessable income of the trust estate (or of another trust estate), the trustee is entitled to a rebate of tax equal to the statutory percentage of the rebatale amount.

Subsection 160AAB(5) of the ITAA 1936 provides that where a trustee of a trust estate is assessed and liable to pay tax pursuant to section 99 or 99A in respect of the whole or part (referred to as the 'relevant trust income') of the net income of the trust estate and the whole or part of that relevant trust income (referred to as the 'rebatale amount') is attributable to an eligible 26AH amount included in the assessable income of the trust estate (or of another trust estate), the trustee is entitled to a rebate of tax equal to the statutory percentage of the rebatale amount.

Reversionary bonuses included in assessable income under section 26AH of the ITAA 1936 in relation to the TEPs are eligible 26AH amounts. The relevant taxpayer (being either the Investors or the Trustee, as applicable) will be entitled to a rebate of tax under section 160AAB of the ITAA 1936 equal to the statutory percentage of the rebatale amount (i.e. 30%) to the extent the applicable rebatale amount referred to in subsections 160AAB(3), (4) or (5) of the ITAA 1936 is attributable to such eligible 26AH amounts included in the assessable income of the unit trust.

Question 4

Summary

Any capital gain or loss made by the Trustee in relation to the TEPs may be disregarded pursuant to item 3 in the table in subsection 118-300(1) of the ITAA 1997.

Detailed reasoning

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?).

Item 3 of the table in 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).

In the context of restructured policies, paragraph 14 of IT 2346 *Income tax: bonuses paid on certain life assurance policies - section 26AH - interpretation and operation* says:

... where existing eligible policies are consolidated by applying cash surrender values and accumulations in respect of those policies into a new life assurance policy, **or where a policy is converted to a different policy table (e.g., whole of life to endowment assurance), a new eligible policy is created.** [emphasis added]

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As a result of the conversion of the policy from a whole of life policy to an endowment policy at the same time as the registration of its purchase (and in accordance with paragraph 14 of IT 2346), a new policy will have been created. As the Trustee of the unit trust is the new holder of that policy, it will be regarded as an original owner of a policy of insurance on the life of an individual.

Accordingly, the Trustee of the unit trust will be entitled under item 3 in the table in subsection 118-300(1) of the ITAA 1997 to disregard any capital gain or loss that it makes in respect of the TEP.

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