Friends Provident International

Moving to Australia

Taxation guidance for investment-linked life assurance policies

For financial advisers only.

Introduction

This guide provides information for individuals who own a Friends Provident International Limited (FPI) investment-linked life assurance policy and are considering moving to Australia, or have already become resident in Australia.

This applies to both Australian nationals returning to Australia and also to foreign nationals moving to Australia.

Taxation in Australia

Income tax liability is determined under domestic law according to the principles of residency and source.

Income tax is payable by Australian resident individuals to the Australian Tax Office (ATO), on non-exempt income derived from worldwide sources and is classed as 'Ordinary Income.'

There is no separate capital gains tax, but capital gains are included in taxable income and classed as 'Statutory Income.'

Australian Residency Test

The primary test of tax residency is called the 'resides test'. The ATO can also apply three statutory tests if an individual does not meet the 'resides test':

Domicile test

This test applies if your domicile is in Australia, unless the ATO are satisfied that your permanent place of abode is outside of Australia.

183-day test

This test applies to individuals arriving in Australia. You will be regarded as resident under this test if you're actually present in Australia for more than half the income year.

Superannuation test

This test applies to Australian Government employees who are contributing members of the Public Sector Superannuation Scheme (PSS) or the Commonwealth Superannuation Scheme (CSS).

Gross roll up – a valuable tax deferral benefit

A key benefit of an offshore policy is **gross roll-up**. This means that investments held inside the policy can grow without Australian taxation. This means more of the money can stay invested and grow over time.

Example: AUD 200,000 invested with an 8% annual return.

Investment route	Tax position in the year	Amount left invested after year one
Direct investment	The AUD 16,000 return on investment made up of interest and dividends may be taxable. For a higher-rate taxpayer, this could result in tax of up to AUD 7,200, reducing the amount available to remain invested.	**AUD 208,800**
FPI policy	The increased value of AUD 16,000 is not subject to taxation and remains within the policy.	**AUD 216,000**

FPI advantage: AUD 7,200 more remains invested within the policy. This additional amount can continue to benefit from compounding over the long term.

Example - Withdrawal

Oliver (an Australian national) was resident in Thailand at the time an FPI investment-linked life assurance policy was recommended by his financial adviser.

- Oliver invested AUD 200,000 into the policy, which commenced on **1 September 2011**. No additional investments have been made.
- On **1 August 2016**, Oliver decided to return to Australia.
- On **1 February 2020**, the policy is valued at AUD 350,000. In **policy year 9** Oliver looks to make a withdrawal of AUD 100,000 from his policy and seeks taxation advice from his tax adviser.
- **Assessable Bonus** = (partial surrender/current surrender value) x bonus on whole policy x 2/3
- **Assessable Bonus** = 100,000/350,000 = 0.28 x 150,000 = 42,857 x 2/3 = **AUD 28,571**
- **AUD 28,571** is the amount that Oliver will need to declare on the tax return submitted to the ATO.
- **Total policy growth** = AUD 350,000 – AUD 200,000 = **AUD 150,000**
- Portion of the policy being withdrawn = **0.2857** (AUD 100,000 withdrawal / AUD 350,000 current value)
- **Capital component:**
  $100{,}000 \times \frac{200{,}000}{350{,}000} = 100{,}000 \times 0.5714 =$ **57,143**
- **Growth component:**
  $100{,}000 \times \frac{150{,}000}{350{,}000} = 100{,}000 \times 0.4286 =$ **42,857**
- So, the AUD 100,000 withdrawal consists of:
  Return of original capital = AUD 57,143
  Realised gain (growth) = AUD 42,857

Example - Full Surrender

Continuing from the previous example, the calculation for a full surrender is as follows:

Assessable Bonus = (surrender value + previous withdrawals) minus (total premiums + previously paid taxable bonus).

If Oliver were to fully surrender his policy in year 10 when it was valued at AUD 300,000, the calculation would be:

Assessable Bonus = (300,000 + 100,000) minus (200,000 + 28,571) = AUD 171,429 x 1/3 = AUD 57,143

Oliver will need to declare the amount of AUD 57,143 on his tax return.

However, if Oliver had waited until the 11th policy year before deciding to surrender the policy, the whole Assessable Bonus (AUD 171,429) would have been tax free.

Taxation when accessing benefits

When benefits are taken from the policy, depending on the period of ownership, any gains may be taxable as **Ordinary Income**.

Under section 26AH of the Australian Income Tax Act 1936, gains on certain life assurance policies are treated as a '**bonus**' from an '**eligible policy**', during an '**eligible period**'.

A **bonus** represents the profit or gain element passed onto the policyholder. For example, where a policy is linked to the purchase and sale of investment units, the profit from their sale is, when paid to the policyholder, regarded as a payment by way of a bonus.

An **eligible policy** is a life assurance policy that commenced after the 27 August 1982.

The **eligible period** for policies that commenced after 7 December 1983, is the first 10 years from the start date of the policy. The following amount of the bonus is included in the policyholder's ordinary income:

Policy Years 1 – 8

100% of the bonus is assessable.

Policy Year 9

Two thirds of the bonus is assessable.

Policy Year 10

One third of the bonus is assessable.

Policy Year 11 onwards:

The bonus is not assessable to any tax.

Re-starting of the eligible period

The ten year eligible period in respect of a policy will recommence to the start of any policy year in which total premiums paid exceed more than 25% the amount paid in the previous policy year.

For example: for a regular premium policy with total annual premium of AUD 10,000 the payments can be increased up-to AUD 12,500 for the following policy year, without the ten year eligible period re-starting.

Please note that where no amount was paid into the policy in the previous policy year, an additional investment will cause the ten year period to re-start from the beginning of that policy year.

Example

- A policy commenced on 1 June 2016, with an initial payment of AUD 200,000. Therefore, the ten year eligible period would be due to end on 31 May 2026.
- On 1 July 2019 (policy year 4), an additional investment of AUD 250,000 was paid into the policy
- As no additional investments were made in policy year 3 (1 June 2018 – 31 May 2019), the ten year eligible period would re-start from 1 June 2019 (i.e. the start of policy year 4).

As a result, the ten year eligible period will now run from 1 June 2019 to 31 May 2029.

Other taxation considerations

Upon the death of the last life assured, there is no liability to income tax. So, if the death benefit is 100% of the surrender value of the policy, then the death benefit will be free of income tax.

Important notes

Every care has been taken to ensure that the information provided is correct and reflects our current understanding of the relevant law.

However, we cannot act as an individual taxation adviser and recommend that independent advice is obtained.

FPI cannot accept any responsibility for any action taken or refrained from being taken as a result of this information.

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