The following information is courtesy of Quilter International and RL360 and is for information purposes only. Please note that every care has been taken to ensure that the information provided is correct and in accordance with their current understanding of the relevant law, as at April 2020.

For individual personalized advice relating to your specific situation, please speak directly with us at Ethical Offshore Investments or your personal financial adviser.

This guide provides information on the tax position of individuals who own a an International / Offshore investment-linked life assurance policy, but in the future become resident in Australia.

This includes:

- Australian nationals returning to Australia
- Foreign nationals moving to Australia

Investing in Offshore / International Life Assurance Policies

Offshore / International life assurance policies can help provide clients real freedom over how they invest and control their money. There are a range of Offshore Life Companies, backed by years of investment expertise and financial strength, that provide flexible policies that allow clients to invest in a wide range of assets, in a stable, tax-efficient environment that can add value to their choices.

Many of the Life Companies are based on the Isle of Man, a tax-efficient location where the Life Companies are currently not liable to income tax, capital gains tax or corporation tax on assets linked to policies. This means that client's investment will be able to grow virtually tax-free. It is possible that withholding tax may be deducted from some of the dividends in their country of origin but once inside the policy, they can accumulate tax-free.

Taxation in Australia – Tax residence in Australia

Australian tax residents pay income tax on their worldwide assessable income, which will include any 'bonus' (explained on page 5) received from their Quilter International life assurance policy.

The Australian Tax Office (ATO) uses a number of tests to establish if an individual is resident for tax purposes
in Australia. If you have moved to Australia, settled there and perhaps taken up employment, then it is quite possible you will pass the 'resides test' to become a resident.

Even if you don't pass the 'resides test', the ATO can apply three statutory tests:

1. *The domicile test –* which considers whether an individual's permanent home is in Australia
2. *The 183 day test –* which looks at whether more than six months have been spent in the country during the tax year
3. *The superannuation test –* which concerns Australian Commonwealth employees serving in overseas postings

Passing any one of these tests will make you a tax resident.

Please note that a full explanation of 'residence' is beyond the scope of this guide.

In Australia, policyholders are taxed on the 'bonus' received from their life assurance policy subject to the provisions of section 26AH of the Income Tax Assessment Act 1936 (ITAA 1936).

The 'bonus' from an 'eligible policy' (explained on the right) is included in the assessable income of the taxpayer if it arises during the 'eligible period'; for example, on full or partial surrender, but not on death.

When the beneficiary is the original beneficial owner or an individual who acquired the policy for no consideration, it is exempt from capital gains tax.

What is a 'bonus'?

The Australian Tax Office uses the term 'bonus' to represent the profit or gain received by the client from an investment-linked life assurance policy.

What is an 'eligible policy'?

An 'eligible policy' is defined as a life assurance policy which commenced after 27 August 1982 and one to which the taxation rules apply (re: below).
Quilter International investment-linked life assurance policies are considered to meet the requirements to be a life assurance policy in Australia.

'Eligible period'

The 'eligible period' is the number of policy years from the commencement date of the policy, during which any bonus received by the taxpayer will be included in their assessable income. The next page explains how the eligible period is restarted following a significant premium increase or additional premium is paid.

Rules for policies

If the policy commenced after 27 August 1982 and on or before 7 December 1983, the eligible period is the first four policy years from the commencement date of the policy.

The amount of bonus which is assessable if a surrender takes place is:

- 100% during years 1 and 2 two thirds during
- year 3
- one third during year 4
- not assessable from year 5 onwards.

Rules for policies starting 27 August 1982 – 7 December 1983

100% bonus assessable		2/3 bonus	1/3 bonus	Not assessable
Year 1	Year 2	Year 3	Year 4	Year 5

If the policy commenced after 7 December 1983, the eligible period is the first ten policy years from the commencement date of the policy.

The amount of bonus which is assessable if a surrender takes place is:

- 100% during policy years 1 to 8 two thirds
- during year 9
- one third during year 10
- not assessable from year 11 onwards.

Rules for policies starting after 7 December 1983

100% bonus assessable	2/3 bonus	1/3 bonus	Not assessable
Year 1 – Year 8	Year 9	Year 10	Year 11 onwards

Example Calculation – Withdrawal from policy

Oliver (an Australian national) was resident in Thailand at the time an Offshore / International Life Assurance policy was recommended by his financial adviser.

- Oliver invested AU$ 200,000 into the policy which commenced on **1st September 2011**. No additional investments have been made
- On **1st August 2016**, Oliver decided to return to Australia
- On **1st February 2020**, the policy value is AU$ 350,000. In **Policy Year 9**, Oliver looks to make a withdrawal of AU$ 100,000 from his policy.
- **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 = AU$ 28,571
- **AU$ 28,571** is the amount that Oliver will need to declare on the tax return for the 2019/20 financial year to the Tax Office.

Example Calculation – Full Surrender of policy

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 now valued at AU$ 300,000, the calculation would be:

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

Oliver would need to declare the amount of AU$ 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 (AU$ 171,429) would have been tax free.

The 25% rule and restarting the eligible period

Before an investor pays an additional premium to their single premium policy or increases the annualised payment amount to their regular premium policy, they should consider the following: -

Single Premiums

The eligible period will restart if an investor pays an additional premium into their single premium policy which is more than 125% of the premium paid in the previous policy year.

For example, if AUS$100,000 was invested in policy year 1, a further investment of AUS$125,000 can be paid in year 2 without the eligible period restarting.

However, if no premium was paid in year 2, an additional investment in year 3 will cause the eligible period to start again from the beginning of policy year 3.

Regular Premiums

If you a client increases payments to their regular premium policy by more than 25% of the annualised amount in the previous policy year, the ten year eligible period starts again from the beginning of the policy year in which the increase takes effect.

For example, if the current annualised premium of a regular premium policy is AUS$12,000, they can increase this to AUS$15,000 for the following policy year.

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

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

The taxation of Offshore / International investment- linked Life Assurance Policies owned by Australian tax resident family trusts

The trust income for income tax purposes includes income from all sources including both domestic and foreign income.

Where a beneficiary is presently entitled to the trust income as it arises, taxation is based on the beneficiary's status as a tax payer in Australia and not the trustees.

If a beneficiary is not presently entitled or they are under a legal disability, the trustees are liable for tax on the income at the top marginal rate of income tax.

The gain arising from a foreign life assurance policy is foreign income in the trust estate assessable for tax in Australia.

Section 26AH ITAA 1936 will determine whether income tax is actually payable.

This document assumes that capital gains tax is not payable because the policy is surrendered by the original owner or the policy is assigned into new ownership for no consideration.

In the two scenarios to the right, it is presumed that the beneficiaries are all tax resident in Australia when the trustees fully surrender or partially surrender the policy, giving rise to a chargeable gain and these beneficiaries are immediately paid a trust distribution using the policy proceeds.

The death of the relevant life assured triggering payment of the death benefit is not a taxable event.

Scenario 1

Australian family trust uses trust cash to invest in a new Offshore / International Life assurance policy

a) Surrender by the trustees followed by an immediate distribution to beneficiaries.

When the policy has been held for at least 10 complete policy years and no large premium increases have occurred that reset the eligible period, then the gain will not be included in trust income and the beneficiaries on receipt of a distribution will not be taxed on the gain attached to the distribution.

When the policy has been held for less than 10 complete policy years (or less than the applicable eligible period), any gain is trust income that is assessable for income tax in accordance with section 26AH ITAA 1936 and the beneficiary with present entitlement will be assessed for income tax on the chargeable gain for the year of receipt. On surrender within 8 policy years, the full gain is assessable, in year 9 two thirds and in year 10 it is one third.

b) Assignment by the trustees to the beneficiaries for no consideration.

The assignment of the policy from the trustee to the beneficiary, for no consideration, is not a taxable event regardless of when this takes place in the life of the policy. The beneficiary becomes the taxable owner of the policy subject to section 26AH ITAA 1936.

Scenario 2

Assignment of an existing policy into an Australian resident family trust

a) The assignment into trust.

When the assignment is made by a non- resident individual, there are no tax consequences. When the assignment is made by a resident individual for no consideration, no amount is assessable for income tax or capital gains tax.
It does not matter whether the assignment takes place within 10 years or after 10 years. The timing of the assignment into trust does not itself create a tax consequence.

b) Surrender by the trustees followed by an immediate distribution to beneficiaries.

When the policy has been held for at least 10 complete policy years and no large premium increases have occurred that reset the eligible period, then the gain will not be included in trust income and the beneficiaries on receipt of a distribution will not be taxed on the gain attached to the distribution.

When the policy has been held for less than 10 complete policy years (or less than the applicable eligible period), any gain is trust income that is assessable for income tax in accordance with section 26AH ITAA 1936 and the beneficiary with present entitlement will be assessed for income tax on the chargeable gain for the year of receipt.

On surrender within 8 policy years, the full gain is assessable, in year 9 two thirds and in year 10 it is one third.

c) Assignment by the trustees to the beneficiaries for no consideration.

The assignment of the policy from the trustee to the beneficiary, for no consideration, is not a taxable event regardless of when this takes place in the life of the policy. The beneficiary becomes the taxable owner of the policy subject to section 26AH ITAA 1936.

The taxation of Offshore / International investment-linked Life Assurance policies owned by non-resident Trusts

There is no taxable event in Australia if an existing policy is assigned to the trustee whilst the assignor is non-resident.

If the policy is assigned to a non- resident trust after the policyholder becomes resident, the controlled foreign trust provisions apply to attribute to the holder the gain on full or partial surrender of the policy.
However, it is likely that s118-300(1) of the Income Tax Assessment Act 1997 would apply to exempt the policyholder from capital gains tax on full or partial surrender of the policy following the assignment.

Australia asserts a very wide jurisdiction in relation to non-resident trust estates that must, in calculating income, establish if there is any Australian source income to which non-resident beneficiaries are presently entitled. The trustee of a non-resident trust with no Australian income is not assessable for tax in Australia. Gains on full or partial surrender from Quilter International policies will be foreign sourced.

The resident beneficiary in a non-resident trust is taxed in Australia, in accordance with section 99B ITAA 1936, on distributions paid to them from the trust or applied for their benefit. In the example below, it is presumed that the beneficiaries are all tax resident in Australia when the trustees surrender the policy and make an immediate distribution to a beneficiary or when the trustees assign the policy to the beneficiary.

Offshore / International Life Assurance policies, when structured correctly, can potentially provide significant tax benefits for clients that are returning to or becoming Australian Tax residents.

At Ethical Offshore Investments, we can provide guidance on not only the relevant product for your personal requirements, but also the ongoing timing strategy to ensure that you make the most of the tax benefits that these products provide.

We can also provide guidance with the underlying investment portfolio through either the bespoke Portfolio Management Service or the Sustainable Ethical Allocation model portfolios.

If you are an Australian or someone that may be heading to Australia in the future, please click on the request information button below.