



Australian Expatriates

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Taxation Of Foreign Life Policy Proceeds (Individual Policyholders)

An Australian tax payer is assessed for income tax on the chargeable gains arising from life assurance policies in accordance with Section 26AH of the Income Tax Assessment Act 1936 ("ITAA 36"). Section 26AH was inserted by the Income Tax Assessment Amendment Act 1984 and applies to "eligible policies"; those that commenced after 27 August 1982. This legislation is applicable to resident policyholders of foreign life policies and provides for the taxation of bonuses paid on termination or at the time of a partial withdrawal.

Bonuses Received By The Policyholder

Section 26AH ITAA 1936 provides for the taxation of bonuses when received by the policyholder. The meaning of "bonus" is not actually defined in the legislation but the Australian Tax Office (ATO) has provided a ruling in IT2346 explaining that for investment unit linked policies, the profit derived on the sale of units is, when paid to the policyholder, to be regarded as a bonus payment. The gain or surrender or partial withdrawal is therefore a 'bonus' payment from a foreign unit linked single premium or regular premium policy.

The ATO has ruled that 'received' means the policyholder has actually been paid and received as a cash payment the policy proceeds including the profit element. The policyholder will also be deemed to have received a bonus when it is paid to someone on their behalf for the purpose of reinvestment outside the policy.

A bonus is not received if it is reinvested in the same policy and used to purchase further units on behalf of the policyholder which then contribute to the surrender value of the policy. Such a bonus payment would include loyalty bonuses that increase the unit holding on a periodic basis.

Tax On Full Or Partial Surrender (Encashment)

If a policy has made an investment gain and is held for ten years or more (or extended eligible period as per the paragraph below), any gain made on surrender or maturity may be disregarded if the beneficiary (i) is the original beneficial owner of the policy; or (ii) acquired the interest in the policy for no consideration.

The holding period includes when the policyholder was a non-Australian resident.

In accordance with Section 26AH (6) ITAA 1936, the policyholder will be assessed for income tax on chargeable bonuses arising during the eligible period as follows:

Within 8 years	The full gain is included as assessable income and taxed at the policyholder's marginal rate
During the 9 th year	Two thirds of the gain is included as assessable income and taxed at the policyholder's marginal rate
During the 10 th year	One third of the gain is included as assessable income and taxed at the policyholder's margin rate
After 10 years	The whole gain does not have to be included as assessable income under Section 26AH

Extending The Eligible Period Following A Significant Premium Increase

To guard against a deliberate attempt to gain a tax advantage on certain capital investments by paying only nominal premiums at outset which are then significantly increased later, Section 26AH (13) provides that if the premium is increased by an amount in excess of 25% of the premium paid in the previous policy year, the eligible period shall be extended and will be 10 years from the start date of the policy year in which the premium increase takes place. Until such time as this new revised eligible period is completed, bonuses received will remain assessable to income tax.

Death Benefits Payable Under The Policy

In accordance with Section 26AH(7) the amount paid on the death of the life assured resulting in the policy terminating is not assessable to income tax on receipt by a tax payer.

Also, the estate of the deceased will not be subject to capital gains tax on the proceeds as they will be received with no consideration resulting in any gain or loss being disregarded.