QUESTIONS AND ANSWERS
- SOCIAL SECURITY INCOME AND ASSETS TESTS –
ASSESSMENT OF CONVENTIONAL LIFE INSURANCE POLICIES

These Questions and Answers are about the income and assets tests treatment of conventional life insurance policies which have profit components and surrender values. These policies are principally 'pure endowment', 'endowment' or 'whole-of-life'.

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Q1. Why are profits from conventional life insurance policies included in the social security income test?

A1: While the main purpose of conventional life insurance policies is to provide death cover, some policies include an investment element which may pay bonuses* to the investor. A person who invests in such a life insurance policy is seen as deriving income from a profit-making transaction.

To ignore the income from life insurance policies for income test purposes would be:

- inequitable compared with the treatment of other products; and
- inconsistent with the intention of the *Social Security Act 1991* to assess income from all sources, with very limited exemptions. The income test is used to target income support to people at times of financial need while ensuring that the social security safety net remains sustainable for Australian taxpayers.

* The term 'bonuses' used throughout means all profits on life insurance.

Q2. What is the current treatment of a conventional life insurance policy under the social security means test (that is, under the income and assets tests)?

A2. During the term of the policy:

- bonuses are not assessed as income
- the surrender value of the policy is assessed as an asset

- the asset value of the policy is reduced by the amount of the encumbrance if the customer borrows against the policy.

Upon withdrawal** from a policy (whether by surrender or by the policy reaching the maturity date first specified for the policy):

- the difference between:
  - the surrender/maturity value; and
  - the sum of the purchase price (if any) and the premiums paid by the investor over the life of the product is held as income over 12 months (under the income test)
- the assets test treatment depends on what is done with the money. For example, if it is used to purchase a motor vehicle, the value of the motor vehicle will be assessed as an asset of the person. If it is used to pay off a mortgage on the principal home, it will not be assessed because the principal home is an exempt asset. If it is placed in a financial investment it will be assessed as a financial asset and it will be treated under the income test deeming rules.

  Caution: the precise effect of the withdrawal, and the use to which the money is put, depends on the circumstances of the individual. As well, the withdrawal may result in a person's assessment changing from the assets test to the income test and vice versa.

** Where a policy has matured but none or only part of the maturity entitlement is withdrawn, at the point of maturity the treatment is the same as if a full withdrawal had been made. This is because income is assessable when a person first has legal entitlement to it.

The balance remaining with the insurance company is then treated in the same way as any other financial asset and is assessed under the income test deeming rules.

Q3. When did the income test assessment of conventional life insurance policies change?

A3: Prior to 21 July 1997, bonuses on conventional life insurance policies were not assessed as income. After 21 July 1007 the income testing of policies at surrender or maturity changed as a result of a clarification of policy to ensure that there was no misinterpretation of the *Social Security Act 1991.*

Q4. Are the entire accumulated bonuses assessed as income?

A4: Yes. The entire accumulated bonuses are assessed as income, irrespective of the period during which the customer received social security payments. The value of the accumulated bonuses is calculated

by subtracting the sum of the purchase price and the premiums paid by the investor from the surrender/maturity value.

Q5. What happens if only the bonuses are cashed in?

A5: The value of the bonuses is assessed as income over 12 months.

Q6. Are bonuses assessed as income when they are received before claiming social security payment?

A6: Yes. Bonuses received up to 12 months before a claim is made for social security income support are assessed as income. A person is taken to receive the bonus income for 12 months commencing the day on which the person becomes entitled to that bonus.

Q7: Is a conventional life insurance policy deemed?

A7: No. During its life, a conventional life insurance policy is not assessed as a financial investment. Amounts withdrawn from a conventional life insurance policy that are reinvested in a financial investment would be assessed under the income test deeming rules.

Q8. Are there any exceptions to the current treatment set out in A1? (Have any such policies ever been deemed?)

A8: Yes. A small number of insurance products which were once assessed under the income test deeming rules are not regarded as conventional life insurance policies.

For each of these policies (see table below), the only bonuses now subject to the income test treatment in **A1** are those bonuses accumulated from the date the policy was no longer assessed as a financial investment.

CONVENTIONAL LIFE INSURANCE POLICY PREVIOUSLY CONSIDERED A FINANCIAL INVESTMENT	DATE ASSESSMENT CHANGED
Australian Catholic Guild Friendly Society Blue Chip Endowment Bond (now managed by the Grand United Friendly Society)	20 March 1997
Australian Catholic Guild Friendly Society Blue Chip Endowment Bond No. 2	20 March 1997
Lumley Life Limited Capital Guaranteed Pure Endowment Plan	20 March 1997
MLC Life Limited Guaranteed Portfolio Endowment	20 March 1997

Plan	
MLC Life Limited Pure Endowment Plan	20 March 1997
Manchester Unity Blue Chip Endowment Assurance Fund	26 May 1997
Grand United Grand Bonds Assurance Fund	9 July 1997
Hibernian Blue Chip Assurance Certificates	2 September 1997
Newcastle Friendly Society Our Town Bond Fund	24 September 1997

Q9. How is a policy assessed when ownership is gifted to another?

A9 (a): For the person making the gift the asset value, less the allowable gifting amount, will be assessed as a deprived asset and deemed under the means test for five years from the date of disposal.

A9 (b): For the person receiving the gift the income assessable upon surrender or maturity will be the difference between the surrender/maturity value and the sum of the surrender value at time of receipt of the gift plus any premiums paid by the recipient of the gift.

Caution: the precise effect of the gifting depends on the circumstances of the individual. 'Gifting' may result in a person's assessment changing from the assets test to the income test and vice versa.

Q10. How is a traded policy assessed – for the seller? – for the purchaser?

A10 (a): In the hands of the person selling the policy, the proceeds from the sale will be assessed under the income test in exactly the same way as the amount received upon surrender or upon maturity (refer **A1**). If the full value is not received, the assets test deprivation assessment outlined in **A9** applies.

Example:

The original owner buys an endowment insurance policy having a sum insured of $10,000 and pays premiums totalling $7,000. There is no initial purchase price.

After accumulating bonuses to the value of $4,000, the policy is sold for $13,000.

The income assessed for the original owner is $6,000, calculated as follows:

- the sale price of $13,000 minus $7,000, which is the sum of the purchase price ($0) and the value of the premiums paid ($7,000).

A10 (b): In the hands of the purchaser, the income assessable upon surrender or maturity is the difference between the surrender/maturity value and the sum of the purchase price paid by the purchaser and any premiums paid by the purchaser.

Example:

The purchaser of the policy in the above example continues to meet the premium payments, paying a total of $3,000 in premiums. The policy accumulates further bonuses and then matures, with a maturity value of $20,000.

The income assessed for the purchaser upon maturity is $4,000, calculated as follows:

- the maturity value of $20,000 minus $16,000, which is the sum of the purchase price ($13,000) plus the value of premiums paid since the policy changed hands ($3,000).

Q11. Are borrowings against a policy assessed under the income test?

A11. No. Genuine borrowings by a policy owner are not assessed as income, but neither do they reduce the surrender/maturity values for income test purposes – refer to **Q12 and A12.**

Q12. Are bonuses never seen by the owner of a policy (because they are used to repay a loan from the life insurance company against the policy) assessed as income?

A12. Yes. The bonuses are considered to be income, as the owner of the policy has benefited from the use of the bonuses to reduce the loan (the borrowings) from the life insurance company.

Q13. What happens when a partial withdrawal is made during the term of the policy?

A13. The assessment of partial withdrawals can be complex. Only the profit (investment earnings component) of the withdrawal is assessed as income over 12 months.

For a partial withdrawal the amount is reduced proportionally:

Profit multiplied by the **amount of withdrawal** divided by the **value of the investment at withdrawal.**

Example:
A customer withdraws $20,000 from a policy with a surrender/maturity value of $60,000 and a profit component of $30,000. To calculate the amount of income to be assessed for social security purposes:

$$30{,}000 \times \frac{20{,}000}{60{,}000} = \$10{,}000 \text{ to be assessed.}$$

Note 1: Subsequent withdrawals will be assessed similarly.

Example:
After the first withdrawal, the above policy has a surrender/maturity value of $40,000 and a profit component of $20,000 (the original component minus the amount assessed as income).

The customer withdraws a further $20,000.

To calculate the amount of income to be assessed for social security purposes:

$$20{,}000 \times \frac{20{,}000}{40{,}000} = \$10{,}000 \text{ to be assessed.}$$

Note 2: Where a policy has matured but is not fully withdrawn, at the point of maturity the treatment is the same as if a full withdrawal has been made: refer to ***A1.*** *As well, the amount remaining with the insurance company is treated as any other financial asset and deemed accordingly.*

Q14. Can the profit from one policy be offset against the losses from another?

A14. No. The profits arising from one conventional life insurance policy cannot be offset against the losses from another policy.

Q15. How is a payment of an insurance death benefit assessed?

A15. Life insurance offices commit to paying a specified minimum benefit on the occurrence of particular events such as the death of the insured.

A death benefit is not assessed as income for the person nominated to receive the benefit.

- Assets test assessment will depend on how the money is used. For example, if it is used to pay out the mortgage on a principal home it becomes part of an exempt asset. If it is placed in a financial investment, it will be assessed as a financial asset and it will be treated under the income test deeming rules.

FURTHER INFORMATION

For people who want to enquire about the impact of life insurance policies on their social security income support entitlement, Centrelink can be contacted on 13 2300.

DISCLAIMER:

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