



HEALTHIER, LONGER,
BETTER LIVES

AIA INSURANCE TAX GUIDE

FY 2025/26

Tax treatment of insurance cover

The information in this guide is a general summary of the tax issues associated with various types of insurance policies and ownership structures. It is not an exhaustive list. Clients should refer to their tax adviser for more information on their specific circumstances.

Life cover

Purpose of policy	Owner	Premiums paid by	Premium deductible to the payer	Proceeds subject to income tax		Proceeds subject to capital gains tax (CGT)
Personal protection	Life insured	Life insured	No	No		No ¹
	Life insured	Employer	Yes ² Note – fringe benefits tax (FBT) may apply ³	No		No ¹
	Life insured's employer	Employer	Yes ² Note – (FBT) may apply ³	Yes, assessable as income to employer ⁴ For beneficiary, proceeds taxed as death benefit employment termination payment (ETP) ⁴		No ¹
	Another individual (cross ownership)	Policy owner	No ¹	No		No ¹
	Trustee of a complying super fund	Trustee	Yes	Paid to tax dependant	No if lump sum death benefit Potentially yes if death benefit income stream ⁵	No ¹
				Paid to non-tax dependant	Yes ⁵	
Key person – revenue purposes	Business entity	Business entity	Yes	Yes		No, as proceeds assessable as ordinary income
Key person – capital purposes or debt protection cover	Business entity	Business entity	No	No		No ¹
Business succession funding	Life insured (self ownership)	Life insured	No	No		No ¹
	Another individual (cross ownership)	Policy owner	No	No		No ¹
	Trustee	Trustee	No	No		No ¹
	Company	Company	No	No		No ¹

Note:

'Another individual' (ie. cross ownership) as policy owner is someone other than the life insured or their employer.

'Business entity' as policy owner includes a partnership, trustee of a trust or a company.

Life cover – paid under a terminal illness benefit

Purpose of policy	Owner	Premiums paid by	Premium deductible to the payer	Proceeds subject to income tax	Proceeds subject to capital gains tax (CGT)
Personal protection	Life insured	Life insured	No	No	No ¹
	Life insured	Employer	Yes ² Note – fringe benefits tax (FBT) may apply ³	No	No ¹
	Life insured's employer	Employer	Yes ² Note – (FBT) may apply ³	Yes, assessable as income to employer ⁴ For beneficiary, proceeds taxed as death benefit employment termination payment (ETP) ⁴	No ¹
	Another individual (cross ownership)	Policy owner	No ¹	No	No ¹
	Trustee of a complying super fund	Trustee	Yes	No ⁶	No ¹
Key person – revenue purposes	Business entity	Business entity	Yes	Yes	No, as proceeds assessable as ordinary income
Key person – capital purposes or debt protection cover	Business entity	Business entity	No	No	No ¹
Business succession funding	Life insured (self ownership)	Life insured	No	No	No ¹
	Another individual (cross ownership)	Policy owner	No	No	No ¹
	Trustee	Trustee	No	No	No ¹
	Company	Company	No	No	No ¹

Total and permanent disablement (TPD)

Purpose of policy	Owner	Premiums paid by	Premium deductible to the payer	Proceeds subject to income tax	Proceeds subject to capital gains tax (CGT)
Personal protection	Life insured	Life insured	No	No	No ⁷
	Life insured	Employer	Yes ² Note – fringe benefits tax (FBT) may apply ³	No	No ⁷
	Life insured's employer	Employer	Yes ² Note – (FBT) may apply ³	Yes, assessable as income to employer ⁴ For employee, proceeds taxed as life benefit ETP ⁴	No ⁷
	Another individual (cross ownership)	Policy owner	No	No	No, if paid to life insured or their relative ⁷
	Trustee of a complying super fund	Trustee	Yes ⁸	Under age 60 – Yes ⁹ Over age 60 – No	No ¹
Key person – revenue purposes	Business entity	Business entity	Yes	Yes	No, as proceeds assessable as ordinary income
Key person – capital purposes or debt protection cover	Business entity	Business entity	No	No	Yes, unless paid to life insured, their relative or trustee of trust (where beneficiary of trust is the life insured or their relative) ⁷
Business succession funding	Life insured (self ownership)	Life insured	No	No	No ⁷
	Another individual (cross ownership)	Policy owner	No	No	No, if paid to life insured or their relative ⁷
	Trust	Trustee	No	No	No ⁷
	Company	Company	No	No	Yes ¹⁰

Crisis recovery (trauma)

Purpose of policy	Owner	Premiums paid by	Premium deductible to the payer	Proceeds subject to income tax	Proceeds subject to capital gains tax (CGT)
Personal protection	Life insured	Life insured	No	No	No ⁷
	Life insured	Employer	Yes ² Note – fringe benefits tax (FBT) may apply ³	No	No ⁷
	Life insured's employer	Employer	Yes ¹¹ Note – (FBT) may apply ³	Yes, assessable as income to employer ⁴ For employee, proceeds taxed as life benefit ETP ⁴	No ⁷
	Another individual (cross ownership)	Policy owner	No	No	No, if paid to life insured or their relative ⁷
	Trustee of a complying super fund ¹²	Trustee	No	Depends on condition of release met	No ¹
Key person – revenue purposes	Business entity	Business entity	Yes	Yes	No, as proceeds assessable as ordinary income
Key person – capital purposes or debt protection cover	Business entity	Business entity	No	No	Yes, unless paid to life insured, their relative or trustee of trust (where beneficiary of trust is the life insured or their relative) ⁷
Business succession funding	Life insured (self ownership)	Life insured	No	No	No ⁷
	Another individual (cross ownership)	Policy owner	No	No	No, if paid to life insured or their relative ⁷
	Trust	Trustee	No	No	No ⁷
	Company	Company	No	No	Yes ¹⁰

Income protection

Purpose of policy	Owner	Premiums paid by	Premium deductible to the payer	Proceeds subject to income tax	Proceeds subject to capital gains tax (CGT)
Personal protection	Life insured	Life insured	Yes	Yes	No
	Life insured	Employer	Yes ² Note – fringe benefits tax (FBT) may apply ³	No	No
	Life insured's employer	Employer	Yes ¹¹ Note – (FBT) may apply ³	Yes, assessable as income to employer Income protection ⁴	No
	Trustee of a complying super fund ¹²	Trustee	No	Depends on condition of release met	No ¹

Business expenses

Purpose of policy	Owner	Premiums paid by	Premium deductible to the payer	Proceeds subject to income tax	Proceeds subject to capital gains tax (CGT)
Business overheads funding	Life insured (business owner)	Life insured	Yes	Yes	No
	Business entity	Business entity	Yes	Yes	No

Tax on employer owned insurance benefits (non-super policies)

Under employer owned insurance policies, the following will generally occur:

- The owner of the policy is the employer
- The employer pays the premiums
- The employer is the beneficiary of the insurance proceeds, and
- The lives insured are employees of the employer and the employees are not party to the policy (other than being named as the lives insured).

Thus, the tax implications of employer owned insurance benefits are summarised below.

Death benefit

- Tax treatment for the employer: insurance proceeds paid are assessable as income to the employer. Payment of proceeds by the employer to the employee's beneficiaries or estate is tax deductible to the employer.
- Tax treatment for the beneficiary: where the proceeds are paid (within 12 months of death) as a result of the death of the employee, the amount will generally be a 'death benefit employment termination payment' (death benefit ETP).

A death benefit ETP is taxed as follows:

Recipient	Tax on taxable component*
Tax dependant [^]	0% up to \$260,000 [∞]
	47% over \$260,000 [∞]
Non-tax dependant [^]	32% up to \$260,000 [∞]
	47% over \$260,000 [∞]

[^] A tax dependant includes a spouse (including de facto, same-sex or former spouse), children under 18, or any person who was in an interdependency relationship or was financially dependent on the deceased before they died. Children aged 18 and over are not tax dependants unless they can prove they were financially dependent on the deceased

* All tax rates includes Medicare levy

[∞] ETP cap amount for FY 2025/26

Terminal illness benefit

If an employer pays an early death benefit to an employee as a result of a terminal illness, the payment will be considered a 'life benefit ETP' if the employee is diagnosed as terminally ill, and in the opinion of treating doctor and/or treating specialist, the illness or injury is likely to result in death within a certain time frame (ie. 12 or 24 months, depending on the insurer).

In this case, the terminal illness payment will generally be taxed as a 'life benefit ETP'.

A life benefit ETP is taxed as follows:

Age	Tax on taxable component*
Under preservation age	32% up to \$260,000 [∞]
	47% over \$260,000 [∞]
Over preservation age	17% up to \$260,000 [∞]
	47% over \$260,000 [∞]

* All tax rates include Medicare levy

[∞] ETP cap amount for FY 2025/26

Total and permanent disablement (TPD)

- Tax treatment for the employer: insurance proceeds paid are assessable as income to the employer. Payment of proceeds by the employer to the employee is tax deductible to the employer.
- Tax treatment for the beneficiary: where the proceeds are paid as a result of termination of employment, the benefit is paid as a life benefit ETP (refer to life benefit ETP table above for tax treatment of proceeds).

This payment may include an invalidity segment, providing a tax-free component which represents the time between the day employment stopped due to ill health and the day the employee would have retired (ie. age 65).

The tax-free invalidity segment can only be paid if two medical practitioners have certified that it is unlikely the employee can ever be gainfully employed in the capacity for which they are reasonably qualified.

Crisis recovery (trauma)

- Tax treatment for the employer: insurance proceeds paid are assessable as income to the employer. Payment of proceeds by the employer to the employee is tax deductible to the employer.
- Tax treatment for the beneficiary: where the proceeds are paid as a result of termination of employment, the benefit is paid as a life benefit ETP (refer to life benefit ETP table above for tax treatment of proceeds).

Income protection

- Tax treatment for the employer: insurance proceeds paid are assessable as income to the employer. Payment of proceeds by the employer to the employee are tax deductible to the employer.
- Tax treatment for the employee: the payments will be included in the employee's assessable income and taxed at their marginal tax rate.

Tax on super owned insurance benefits

Death benefits

The tax treatment of death benefits depends on:

- Whether a tax dependant or non-tax dependant receives the benefit
- The underlying components of the superannuation benefit, and
- Whether the benefits are paid as a lump sum or as an income stream.

Definition of dependant

The following table summarises the difference between a superannuation and tax law dependant and the types of death benefit that can be paid.

	Super (SIS) dependant?	Tax dependant?	Can death benefits be received directly as a lump sum?#	Can death benefits be received as an income stream?
Spouse (legal, defacto, same sex)	Yes	Yes	Yes	Yes
Former spouse	No*	Yes	No	No
Child (natural, step, adopted, ex-nuptial)				
Under 18	Yes	Yes	Yes	Yes [^]
Over 18	Yes	No*	Yes	No
Disabled child of any age	Yes	Yes~	Yes	Yes
Financial dependant	Yes	Yes	Yes	Yes
Interdependent	Yes	Yes	Yes	Yes
Person receiving benefit because of the death of another person who died in the line of duty (eg military or police)	No	Yes	Yes	No

* Unless financially dependent on the deceased

[^] Income stream must be commuted by the time the child turns 25

~ A disabled child age 18 and over will only be a tax dependant if also financially dependant or an interdependent

In each case, even where super trustee may not pay a lump sum directly, the benefit may be directed to the legal personal representative (LPR) and a lump sum paid to the beneficiary via the estate in accordance with a valid will. Where a super lump sum benefit is paid via the deceased's estate, no tax is withheld by the super fund. The deceased's LPR is responsible for withholding tax from the benefit depending on whether a tax dependant or non-tax dependant receives the benefit.

Tax on super death benefit lump sums

Beneficiary	Direct to beneficiary		Via estate	
	Taxable component (taxed element)	Taxable component (untaxed element)	Taxable component (taxed element)	Taxable component (untaxed element)
Tax dependant	Nil	Nil	Nil	Nil
Non-tax dependant	Marginal tax rate or 17%*, whichever is lower	Marginal tax rate or 32%*, whichever is lower	15% [^]	30% [^]

* Includes Medicare levy

[^] Medicare levy does not apply

Tax on super death benefit income streams (paid to beneficiary)

Age of deceased	Age of beneficiary	Taxable component (taxed element)	Taxable component (untaxed element)
Under age 60	Under age 60	Marginal tax rate* with 15% tax offset	Marginal tax rate*
	Age 60 and over	Nil	Marginal tax rate* with 10% tax offset
	Any age	Nil	Marginal tax rate* with 10% tax offset

* Includes Medicare levy

Tax on terminal illness benefit lump sums

Component	Age	Tax
Any	Any	Nil

Tax on disability super benefit lump sums (TPD)

Age	Taxable component (taxed element)	Taxable component (untaxed element)
Under preservation age	Any	32%* up to \$1,865,000~ 47%* over \$1,865,000~
Preservation age to 59	0% up to \$260,000∞ 17%* over \$260,000∞	17%* up to \$260,000∞ 32%* on \$260,000∞ to \$1,865,000~ 47%* over \$1,865,000~
Age 60 and over	Nil	17%* up to \$1,865,000~ 47%* over \$1,865,000~

* Includes Medicare levy

∞ Low rate cap amount for FY 2025/26

~ Untaxed plan cap amount for FY 2025/26

Tax on disability super benefit income streams (TPD)

Age	Taxable component (taxed element)	Taxable component (untaxed element)
Under age 60	Marginal tax rate less a 15% tax offset	Marginal tax rate*
Age 60 and over	Nil	Marginal tax rate* with 10% tax offset

* Includes Medicare levy

Tax on temporary incapacity income streams (income protection)

The payments will be included in the client's assessable income and taxed at their marginal tax rate.

Capital Gains Tax (CGT)

The capital gains implications of insurance cover can be complex, particularly where the ultimate recipient of the benefit is different from the life insured or the beneficial owner. CGT implications are summarised in the tables at the beginning of this tax guide. Some common differences are further explained below, however expert tax and legal advice should always be obtained where necessary.

Differences between life cover and TPD / crisis recovery

Under the Income Tax Assessment Act (ITAA)1997 a capital gain made from a life policy is disregarded if the benefit is paid to:

- a) the original owner of the policy, or
- b) an entity that acquired the interest in the policy for no consideration, or
- c) the trustee of a complying superannuation fund.

The original owner is generally taken to be the owner at the time the policy commenced. The definition of consideration is harder to define. The ITAA1997 defines it as 'money' or 'market value of any property' but it can also be viewed in a much broader context. It's critical that the implications of any transfer of ownership are understood before proceeding as this could result in a capital gain being treated as assessable income in the hands of the policyholder at the time of the trigger event.

The ITAA1997 also disregards a capital gain upon receipt of compensation for any injury or illness to the life insured or a defined relative or the trustee of a complying superannuation fund.

A relative is defined as:

- d) the person's spouse, or
- e) the parent, grandparent, brother, sister, uncle, aunt, nephew, niece, lineal descendent or adopted child of that person, or of that person's spouse, or
- f) the spouse of a person referred to in part b)

It's important that the difference between the CGT implications for life cover compared to TPD or crisis recovery cover is understood, particularly where cover is being held for business succession or key person purposes and the business is the policy owner. In the case of life cover, if the business was the original owner then no CGT is payable – but if the business owns the TPD or crisis recovery policy then CGT is likely to be payable.

Business succession – change of ownership

In many cases, life, TPD and crisis recovery policies are self-owned, meaning that the benefit paid under the policy is generally disregarded for CGT purposes.

However, where there is a transfer of assets under a buy/sell agreement e.g. transferring business ownership interest from the deceased partner's spouse to the remaining business partners, it is likely that this transfer will be treated as a CGT event.

It's critical that the CGT treatment of the insurance policy and the transfer of assets are separately considered in any structure which is recommended.

Endnotes

1. Under subsection 118–300(1) of the Income Tax Assessment Act (ITAA) 1997, a capital gain made from a life insurance policy is disregarded if the benefit is paid to:
 - a) the original owner of the policy, or
 - b) an entity that acquired the interest in the policy for no consideration, or
 - c) the trustee of a complying superannuation entity.

If CGT applies, the capital gain will form part of the insurance owner’s assessable income and be taxed at their applicable company or marginal tax rate.
2. Under section 8.1 of the ITAA 1997, premiums will be tax deductible for the employer if the expense is considered to be part of the employee’s remuneration and if the premium expense is necessarily incurred in carrying on a business for the purpose of gaining or producing the business’ assessable income (regardless of whether assessable income is actually produced).
3. Premiums paid in respect of an employee may be considered an expense payment fringe benefit and therefore subject to fringe benefits tax (FBT). FBT is paid by the employer but will also be tax deductible to the employer. However, the employer will usually deduct the cost from the employee’s salary package.
4. Refer to the “Tax on employer owned insurance benefits (non-super policies)” section of the insurance tax guide for more information on the tax treatment of proceeds.
5. Tax treatment of death benefits will depend on whether the recipient is a tax dependant or a non-tax dependant, the underlying components of the superannuation benefit and whether the benefits are paid as a lump sum or as an income stream. If the superannuation fund trustee claimed a tax deduction for the life insurance premiums, the taxable component is generally made up of a combination of a taxed and an untaxed element. Refer to the “Tax on super owned insurance benefits” section of the insurance tax guide for more information about the tax treatment of proceeds.
6. Provided it is paid as a lump sum and the definition of terminal medical condition is satisfied. Under regulation 303–10.01 of the Income Tax Assessment Regulations 1997, a terminal medical condition exists under the following circumstances:
 - a) two registered medical practitioners have certified, jointly or separately, that the person suffers from an illness, or has incurred an injury, that is likely to result in the death of the person within a period (the certification period) that ends not more than 24 months after the date of the certification, and
 - b) at least one of the registered medical practitioners is a specialist practicing in an area related to the illness or injury suffered by the person, and
 - c) for each of the certificates, the certification period has not ended.
7. Under section 118–37(1) of the ITAA 1997, a capital gain made from compensation or damages received for injury or illness is disregarded if the benefit is paid to:
 - a) the life insured or relative of the life insured, or
 - b) the trustee of a trust where a beneficiary of the trust is the life insured or a relative of the life insured.

Subsection 995–1(1) of the ITAA 1997 defines a relative of a person as:

 - c) the person’s spouse, or
 - d) the parent, grandparent, brother, sister, uncle, aunt, nephew, niece, lineal descendent or adopted child of that person, or of that person’s spouse, or
 - e) the spouse of a person referred to in paragraph b)
8. To the extent that the TPD insurance policy provides disability superannuation benefits. Subsection 995–1(1) of the ITAA 1997 defines a disability superannuation benefit to mean a superannuation benefit if:
 - a) the benefit is paid to a person because he or she suffers from ill-health (whether physical or mental), and
 - b) two legally qualified medical practitioners have certified that, because of the ill health, it is unlikely that the person can ever be gainfully employed in a capacity for which he or she is reasonably qualified because of education, experience or training.

9. Proceeds will be taxed as a lump sum superannuation benefit, which may include an increased tax-free component if the definition of disability superannuation benefit (above) can be met. The tax payable on the lump sum superannuation benefit will depend on the age of the recipient as per superannuation withdrawal rules. Refer to the "Tax on super owned insurance benefits" section of the insurance tax guide for more information about the tax treatment of proceeds.
10. If a company is the policy owner and recipient of the proceeds, CGT will be payable as a company is not the life insured or a relative of the life insured.
11. According to ATO TD 95/42, a trauma insurance premium in respect of an employee can be an allowable deduction to the employer provided that:
 - a) the trauma policy is owned by the employer
 - b) the employer is the beneficiary of the policy
 - c) the premium is paid for a revenue purpose, and
 - d) the purpose of the policy is to advance the business ends of the taxpayer.
12. Crisis recovery (trauma) policies within the superannuation environment are prohibited from 1 July 2014 as their terms and conditions do not align with one of the specified conditions of release. Existing policies taken out prior to this date can be retained inside super under grandfathering provisions. Note that proceeds will be paid to the trustee of the super fund and a condition of release must be met to release the funds to the individual, which may be problematic.
13. Employers can allow their employees to salary package (i.e. salary sacrifice) their income protection premiums for a personally owned policy. Where this is the case, the employee may also benefit from income tax savings by forgoing their future entitlement to pre-tax salary or wages in exchange for the employer funding the cost of their income protection premiums. Thus where an employer pays for the income protection premiums for a policy that will provide a benefit to an employee, the premiums are not subject to FBT as the expense is otherwise deductible to the employee.
14. Section 110–25 (2) of the ITAA 1997.