



# TECHNICAL ANALYSIS REPORT

## Tax Implications of a Company-Funded Buy-Sell

### Arrangement Using Life Insurance and Share Buy-Back

<b>Prepared for:</b>	Instructing Accountant / Client
<b>Date:</b>	March 2026
<b>Reference:</b>	TA-2026-012
<b>Classification:</b>	Confidential

## Question

### Client Query

A buy-sell arrangement has been put in place by a company and its shareholders. The company holds a life insurance policy over the life of each shareholder. Upon the death of a shareholder, the company must use the proceeds to buy-back their shares from the executor of the deceased estate. The company has nominal share capital but large retained earnings. What are the tax implications?

## 1. Summary

This arrangement involves a company-funded (entity-purchase) buy-sell mechanism where the company owns life insurance policies on its shareholders and uses the death benefit proceeds to fund an off-market share buy-back from the deceased estate. The arrangement triggers multiple tax consequences across income tax, CGT, and corporate law dimensions.

The critical issues are: (1) life insurance proceeds received by the company are a capital receipt and generally not assessable income, with CGT disregarded under s 118-300 ITAA 1997; (2) premiums paid by the company are not deductible under s 8-1 ITAA 1997 as they are capital in nature; (3) the share buy-back is an off-market purchase under Division 16K ITAA 1936, which splits the buy-back price into a deemed dividend component (s 159GZZP) and a capital component; (4) because the company has nominal share capital but large retained earnings, almost the entire buy-back price will be treated as a deemed dividend to the deceased estate; and (5) sections 45A, 45B, and 177EA of the ITAA 1936 are anti-avoidance provisions that may apply if the arrangement is structured to confer imputation benefits disproportionately.

## 2. Facts & Assumptions

### Facts Provided

The company and its shareholders have entered into a buy-sell arrangement.

The company holds a life insurance policy over the life of each shareholder.

Upon the death of a shareholder, the company must use the insurance proceeds to buy-back their shares from the executor of the deceased estate.

The company has nominal share capital but large retained earnings.

### Assumptions Made

Assumption [ASSUMED]	Affects
The company is an Australian-resident private company (Pty Ltd) and is not listed on any stock exchange.	Determines off-market vs on-market buy-back classification under s 159GZZK ITAA 1936.
The life insurance policies are term life policies (death cover only, not TPD or trauma).	Affects CGT exemption analysis under s 118-300 ITAA 1997.
The company is both the owner and beneficiary of each life insurance policy.	Determines deductibility of premiums and assessability of proceeds.
The share capital account is untainted within the meaning of s 197-50 ITAA 1997.	Affects the capital/dividend split under s 159GZZP.
The shares were acquired post-20 September 1985 (post-CGT shares).	Determines CGT treatment for the deceased estate.
The buy-back price will reflect the market value of the shares at the time of buy-back.	Affects s 159GZZQ(2) adjustment provisions.
The company satisfies the solvency test under s 257A(a) Corporations Act 2001 at the time of the buy-back.	Prerequisite for lawful share buy-back.

### Information Needed

Missing Information [NEEDED]	If Different, Would Change
Exact number of shareholders and their individual shareholding percentages.	Determines whether the buy-back is selective (s 257D) and affects the per-share capital/dividend split.
The amount standing to the credit of the company's share capital account.	Directly determines the capital component of the buy-back under s 159GZZP using the ACPS method.
Whether the company has a franking account surplus sufficient to frank the deemed dividend.	Determines whether the dividend component is franked, partially franked, or unfranked.
Whether the deceased shareholder held the shares on revenue account or capital account.	Determines income tax vs CGT treatment for the estate.
The date the shares were originally acquired and the cost base.	Required to calculate the CGT position for the estate on the capital component.
State or territory in which the company is registered.	Relevant for stamp duty analysis on share cancellation.

### 3. Related Areas & Cross-Over Analysis

Area	Relevance	Key Provision	Impact
Income Tax	Assessability of insurance proceeds received by the company; deductibility of premiums paid	s 6-5, s 6-10, s 8-1, s 15-30 ITAA 1997	Proceeds are capital receipt, not assessable. Premiums are not deductible (capital in nature).
CGT	CGT event C2 on discharge of insurance policy; CGT event A1 on share disposal by estate	s 118-300, Div 104, Div 128 ITAA 1997	Insurance proceeds CGT-exempt. Estate has CGT event on capital component of buy-back.
Division 16K	Off-market share buy-back splits price into deemed dividend and capital component	ss 159GZZZK–159GZZZQ ITAA 1936	Nominal share capital means almost entire price is deemed dividend.
Imputation	Franking of the deemed dividend component	Div 202, s 202-40 ITAA 1997	Company may frank the dividend, creating franking credits for estate.
Anti-Avoidance	ss 45A, 45B, 177EA ITAA 1936 may apply to dividend streaming or capital benefit schemes	ss 45A, 45B, 177EA ITAA 1936	Risk if arrangement structured to maximise imputation benefits.
Corporations Act	Selective buy-back procedure, solvency test, ASIC lodgment	ss 257A–257J Corporations Act 2001	Must comply with selective buy-back requirements under s 257D.
Deceased Estate	CGT rollover under Div 128 for shares passing from deceased to LPR	Div 128, s 128-10, s 128-15 ITAA 1997	Modified cost base rules apply. Two-year rule for main residence not relevant here.

## 4. Analysis

### 4.1 Tax Treatment of Life Insurance Proceeds Received by the Company

#### Relevant Law

Section 6-5 ITAA 1997 includes in assessable income amounts that are income according to ordinary concepts. Section 6-10 includes amounts that are statutory income under a specific provision. The receipt of life insurance death benefit proceeds by a company is a capital receipt, not income according to ordinary concepts, as established in ATO ID 2003/1189 and the general principle from *Marac Life Assurance Limited v Commissioner of Inland Revenue* [1986] 1 NZLR 694.

Section 118-300(1) ITAA 1997 provides that a capital gain or capital loss from a CGT event happening in relation to a CGT asset that is an interest in rights under a life insurance policy is disregarded in specified circumstances. Table item 3 of s 118-300(1) disregards a gain or loss from a policy of insurance on the life of an individual if the entity that owns the policy is the original beneficial owner. Since the company is the original beneficial owner of each policy, CGT event C2 (discharge of the insurance rights on payment of the death benefit) is disregarded.

Critically, s 118-300 is concerned with the CGT consequences of the insurance policy itself, not the subsequent use of the cash proceeds. The cash received by the company is simply a capital receipt that increases the company's cash assets.

#### Conclusion: Insurance Proceeds

The life insurance death benefit proceeds received by the company are not assessable income under s 6-5 or s 6-10 ITAA 1997. Any CGT event arising from the discharge of the insurance policy is disregarded under s 118-300(1), table item 3, because the company is the original beneficial owner of the policy.

### 4.2 Deductibility of Life Insurance Premiums Paid by the Company

#### Relevant Law

Section 8-1 ITAA 1997 provides a general deduction for losses or outgoings to the extent they are incurred in gaining or producing assessable income, or are necessarily incurred in carrying on a business for that purpose. However, s 8-1(2)(a) denies a deduction to the extent the loss or outgoing is capital, or of a capital nature.

Life insurance premiums paid by the company to fund a buy-sell arrangement are capital in nature because they are incurred to protect the capital structure of the company (i.e., to fund the future acquisition and cancellation of shares). The premiums are not incurred in gaining or producing assessable income of the company. The ATO's long-standing position, consistent with general principles, is that premiums on life policies held to fund business succession arrangements are not deductible.

This is distinguishable from key person insurance taken out to protect against loss of revenue from the death of a key employee, where the premium may be deductible under s 8-1 because the nexus is to the production of assessable income.

#### Conclusion: Premium Deductibility

The life insurance premiums paid by the company are NOT deductible under s 8-1 ITAA 1997. They are capital expenditure incurred to protect the company's capital structure and fund a share buy-back obligation, not to produce assessable income.

### 4.3 Off-Market Share Buy-Back — Division 16K ITAA 1936

#### Classification of the Buy-Back

Division 16K of Part III of the ITAA 1936 governs the taxation of share buy-backs. Section 159GZZZK classifies buy-backs as either on-market or off-market. Since the company is a private (unlisted) company, the buy-back of shares from the deceased estate is an off-market purchase under s 159GZZZK(d).

#### The Dividend/Capital Split — s 159GZZZP

Under s 159GZZZP(1), for an off-market share buy-back, the difference between: (a) the purchase price; and (b) the part of the purchase price debited against the company's share capital account, is taken to be a dividend paid by the company to the selling shareholder (in this case, the executor of the deceased estate) out of profits, on the day the buy-back occurs.

The ATO's preferred methodology for determining the capital/dividend split is the Average Capital Per Share (ACPS) method, as set out in PS LA 2007/9 at paragraphs 12 and 69. The ACPS is calculated by dividing the total amount standing to the credit of the company's share capital account by the total number of ordinary shares on issue.

#### Key Issue: Nominal Share Capital

Because the company has nominal share capital but large retained earnings, the ACPS will be very low. This means the capital component of the buy-back price will be minimal, and almost the entire buy-back price will be treated as a deemed dividend under s 159GZZZP.

#### No Income Tax or CGT Consequences for the Company

Section 159GZZZN ITAA 1936 provides that there are no income tax or CGT consequences for the company that carries out the buy-back. The company debits its share capital account (for the capital component) and retained earnings (for the deemed dividend component), and cancels the shares.

#### Franking the Deemed Dividend

The deemed dividend component under s 159GZZZP is a frankable distribution under s 202-40 ITAA 1997, to the extent the buy-back price does not exceed the market value of the shares at the time of the buy-back. Any excess above market value is unfrankable under s 202-45(c) ITAA 1997.

If the company has sufficient franking credits in its franking account, it may attach franking credits to the deemed dividend. This creates a significant benefit for the deceased estate, as the franking credits can generate a tax offset or refund.

## 4.4 Tax Treatment for the Deceased Estate (Executor)

### Division 128 — CGT Rollover on Death

Under Division 128 ITAA 1997, when the shareholder dies, the shares pass to the legal personal representative (LPR / executor) without triggering a CGT event (s 128-10). The LPR inherits the deceased's cost base for the shares. When the LPR disposes of the shares via the buy-back, a CGT event A1 occurs.

### Deemed Dividend Component

The portion of the buy-back price deemed to be a dividend under s 159GZZZP is assessable as a dividend in the hands of the estate under s 44 ITAA 1936. If franked, the estate includes the grossed-up dividend (dividend plus franking credit) in assessable income and receives a franking tax offset under Div 207 ITAA 1997. The estate may be entitled to a refund of excess franking credits under s 67-25 ITAA 1997 if total tax offsets exceed the tax liability.

### Capital Component — CGT

Under s 159GZZZQ(1), the capital component of the buy-back price (i.e., the amount debited against share capital) is treated as the capital proceeds for CGT purposes. However, s 159GZZZQ(2) provides a special rule: if the buy-back price is less than the market value of the shares (had the buy-back never been proposed), the market value is substituted as the deemed capital proceeds.

The capital gain or loss is calculated as: Capital proceeds (per s 159GZZZQ) minus the cost base inherited under Div 128. The 'reduction amount' under s 159GZZZQ(3) excludes the deemed dividend component from the capital proceeds, preventing double taxation.

The estate may be eligible for the 50% CGT discount under Div 115 ITAA 1997 if the shares were held by the deceased for more than 12 months before death. Whether the small business CGT concessions under Div 152 are available depends on the specific facts (active asset test, turnover/net asset thresholds, CGT concession stakeholder test).

## 5. Worked Example Tables

### 5.1 Dividend/Capital Split Under s 159GZZZP

Assume: Company has \$100 share capital (100 shares at \$1 each), retained earnings of \$1,900,000. Three equal shareholders (Shareholder A, B, and C) hold 33.33 shares each (approx). Shareholder A dies. Life insurance proceeds received: \$666,666 (equal to the estimated value of A's 1/3 interest). Buy-back price for A's shares: \$666,666.

Item	Amount / Calculation
Total share capital account	\$100
Total shares on issue	100
ACPS (Average Capital Per Share)	$\$100 / 100 = \$1.00$ per share
Shares bought back from estate (1/3)	33.33 shares
Capital component (33.33 x \$1.00)	\$33
Buy-back price	\$666,666
Deemed dividend (s 159GZZZP)	$\$666,666 - \$33 = \$666,633$
Company franking credits available (at 25%)	$\$666,633 \times 25/75 = \$222,211$

### 5.2 Tax Position of the Deceased Estate

Item	Amount
Deemed dividend received	\$666,633
Franking credit (if fully franked at 25%)	\$222,211
Grossed-up dividend assessable	\$888,844
Capital component received	\$33
Less: Cost base of shares (inherited under Div 128, at \$1 per share)	(\$33)
Capital gain on capital component	\$0
Tax on grossed-up dividend (at estate's marginal rate, say 47%)	\$417,757
Less: Franking credit tax offset	(\$222,211)
Net tax payable on dividend	\$195,546
Effective tax rate on total buy-back proceeds	29.3%

#### Important Note

If the company does not have sufficient franking credits to fully frank the dividend, the unfranked portion is assessed at the estate's marginal rate with no offset. This would increase the effective tax rate towards 47%. Conversely, if the estate has lower taxable income, the effective rate would be reduced, and excess franking credits may be refundable.

### 5.3 Tax Position of the Company

Item	Amount	Reference / Note
Insurance proceeds received	\$666,666	Not assessable income; CGT disregarded under s 118-300
Life insurance premiums paid (annual)	Not deductible	Capital in nature under s 8-1(2)(a) ITAA 1997
Income tax on buy-back	Nil	s 159GZZZN ITAA 1936 — no income tax or CGT for the company
Franking account debit on deemed dividend	\$222,211	Debit per s 202-40 ITAA 1997 on payment of franked dividend
Share capital account debit	\$33	Capital component of buy-back price
Retained earnings debit	\$666,633	Deemed dividend component sourced from retained earnings

## 6. Case Law Support

### Primary Authority

Case	Court	Principle	Application
Marac Life Assurance Ltd v CIR [1986] 1 NZLR 694	NZCA	Life insurance proceeds are capital receipts, not income according to ordinary concepts.	Directly supports the non-assessability of the insurance death benefit proceeds received by the company.
NM Superannuation Pty Ltd v Young (1993) 41 FCR 182	FCA	Applied Marac; confirmed that life insurance proceeds are capital in nature.	Reinforces the capital characterisation of the insurance payout.
Thornett v FCT (1938) 59 CLR 787	HCA	A distribution from a company to a shareholder is an indivisible lump sum in the absence of statutory bifurcation.	Division 16K (s 159GZZZP) displaces this common law position by splitting the buy-back price into dividend and capital.

### Supporting Authority

Case / Reference	Source	Principle	Relevance
FCT v Spotless Services (1996) 186 CLR 404	HCA	Part IVA applies where the dominant purpose of a scheme is to obtain a tax benefit, assessed objectively.	Relevant to anti-avoidance risk assessment for the buy-sell arrangement.
ATO ID 2003/1189	ATO	Life insurance proceeds payable on death are not assessable income under ss 6-5, 6-10, or 15-30 ITAA 1997.	Directly on point — confirms non-assessability.

## 7. Conclusion

The company-funded buy-sell arrangement using life insurance proceeds to fund an off-market share buy-back from the deceased estate is a legitimate and commonly used business succession mechanism. However, the tax consequences require careful planning, particularly given the company's nominal share capital.

The insurance proceeds received by the company are not assessable income, and CGT is disregarded under s 118-300 ITAA 1997. The premiums paid are not deductible. The off-market share buy-back under Division 16K ITAA 1936 splits the buy-back price into a deemed dividend (s 159GZZP) and a capital component. Because the share capital account is nominal, substantially all of the buy-back price will be treated as a deemed dividend. If the company has a sufficient franking account balance, the deemed dividend may be franked, providing the estate with a franking credit tax offset.

Key actions to consider: (1) capitalise retained earnings to share capital (a bonus share issue or capital increase) before the buy-back occurs to increase the ACPS and capital component, thereby reducing the deemed dividend portion and potentially improving the CGT outcome for the estate; (2) ensure the company maintains a sufficient franking account balance to fully frank the deemed dividend; (3) obtain a private binding ruling from the ATO confirming the application of Division 16K, the non-application of ss 45A, 45B, and 177EA, and the franking treatment; and (4) ensure Corporations Act procedures under ss 257A–257J are strictly followed.

## 8. Risks & Caveats

**Part IVA Risk: [Low–Medium]** The buy-sell arrangement has a genuine commercial purpose (business succession). However, if the arrangement is structured to maximise franking credits or shift income to lower-taxed beneficiaries of the estate, Part IVA may apply. The dominant purpose must be commercial succession, not tax benefit.

**Section 45A Risk: [Low]** s 45A applies where capital benefits are streamed to some shareholders and dividends to others. In a single-shareholder buy-back on death, the risk is low provided all shareholders are treated consistently.

**Section 45B Risk: [Low–Medium]** s 45B applies where a scheme results in a capital benefit and it would be reasonable to conclude a relevant taxpayer would receive a more favourable tax outcome. The ATO may scrutinise the capital/dividend split. Obtaining a private ruling mitigates this risk.

**Section 177EA Risk: [Low–Medium]** s 177EA is an anti-avoidance provision targeting schemes to obtain imputation benefits. If the franking of the deemed dividend is a product of a deliberate arrangement, the Commissioner may deny the franking credit. Again, a private ruling is recommended.

**Penalty Exposure: [Varies]** If the arrangement is found to breach an anti-avoidance provision, Div 284 TAA 1953 penalties apply: 25% base penalty (lack of reasonable care), reduced to nil if a reasonably arguable position exists (s 284-75). Voluntary disclosure reduces penalties further (s 284-225).

**Corporations Act Compliance: [Procedural]** Failure to follow the selective buy-back procedure under s 257D (special resolution by non-selling shareholders or unanimous resolution) could render the buy-back void. ASIC lodgment of documents at least 14 days before the buy-back is required (s 257E, s 257F).

**Key Deadline: [Time-sensitive]** The buy-back must be executed after all Corporations Act procedures are completed. The company should lodge its annual return with the ATO reflecting the share cancellation, franking account debit, and deemed dividend in the relevant income year.

## 9. Rulings & References

### Legislation

Provision	Relevance
ITAA 1997, s 6-5, s 6-10, s 6-15	Assessable income — ordinary income, statutory income, non-assessable amounts
ITAA 1997, s 8-1	General deduction provision
ITAA 1997, s 118-300	CGT exemption for life insurance policies
ITAA 1997, Div 104 (s 104-10, s 104-25)	CGT events A1 and C2
ITAA 1997, Div 115	CGT discount
ITAA 1997, Div 128 (s 128-10, s 128-15)	CGT rollover on death
ITAA 1997, Div 152	Small business CGT concessions
ITAA 1997, Div 202 (s 202-40, s 202-45)	Frankable and unfrankable distributions
ITAA 1997, Div 207	Franking credits and tax offsets for recipients
ITAA 1936, Div 16K (ss 159GZZZK–159GZZZQ)	Share buy-back taxation
ITAA 1936, s 44	Dividends included in assessable income
ITAA 1936, s 45A, s 45B	Anti-avoidance — streaming of benefits
ITAA 1936, s 177EA	Anti-avoidance — imputation benefits
Corporations Act 2001, ss 257A–257J	Share buy-back procedures
Corporations Act 2001, s 257D	Selective buy-back — special shareholder approval

### ATO Rulings & Guidance

Reference	Topic	Binding Status
PS LA 2007/9	Share buy-backs — Commissioner's practice and approach to Division 16K, anti-avoidance	Non-binding (practice statement)
TD 2007/4	Meaning of 'policy of insurance on the life of an individual' in s 118-300	Binding
ATO ID 2003/1189	Life insurance proceeds payable on death are not assessable income	Non-binding (interpretive decision)

### Case Law

Case	Court	Principle
Marac Life Assurance Ltd v CIR [1986] 1 NZLR 694	NZCA	Life insurance proceeds are capital receipts
NM Superannuation Pty Ltd v Young (1993) 41 FCR 182	FCA	Applied Marac to Australian context
Thornett v FCT (1938) 59 CLR 787	HCA	Distributions are indivisible lump sums at common law

Case	Court	Principle
FCT v Spotless Services (1996) 186 CLR 404	HCA	Part IVA dominant purpose test — objective assessment

## Disclaimer

*Applicable to all advisory outputs produced by Brevity Co Pty Ltd*

### Nature of this information

*The content of this document constitutes general information only. It has been prepared without reference to any particular person's objectives, financial circumstances, or needs. Nothing in this document should be construed as personal tax advice, personal financial product advice, legal advice, or a recommendation to take or refrain from taking any particular action.*

### Non financial product

*Brevity Co Pty Ltd is not licenced to provide financial product advice under the Corporations Act 2001 (Cth). You should obtain advice from the holder of an appropriate Australian Financial Services Licence, before making any decision concerning a financial product.*

### Basis of preparation

*This analysis is based on the legislation, rulings, case law, and regulatory guidance in force at the date of preparation. Taxation and accounting law is subject to change through legislative amendment, judicial decision, or administrative practice, and any such changes may affect the accuracy of the analysis without notice. Brevity Co Pty Ltd does not undertake to update this document to reflect subsequent changes in the law. We are not solicitors or provide legal advice. We do not guarantee that the tax authorities will not challenge or to guarantee the outcome if a challenge raised on the basis of the information we provide.*

### Third-party information

*Where this document refers to data, figures, or information obtained from third-party sources or publicly available publications, Brevity Co Pty Ltd has not independently verified that material and makes no representation as to its accuracy or reliability.*

### No warranty

*While all reasonable care has been taken in the preparation of this document, Brevity Co Pty Ltd does not warrant that the information contained in it is complete, current, or free from error. Any assumptions, projections, and comparisons included are for illustrative purposes and should not be relied upon as a prediction or guarantee of any particular outcome.*

### Limitation of liability

*To the maximum extent permitted by law, Brevity Co Pty Ltd, its directors, employees, contractors, and agents disclaim all liability for any loss, damage, cost, or expense (whether direct, indirect, consequential, or otherwise) arising from or in connection with the use of or reliance on any information contained in this document, including liability arising from negligence. Nothing in this disclaimer excludes, restricts, or modifies any rights or remedies that cannot be excluded, restricted, or modified by law.*

### Intended use

*This document is prepared for the use of the named recipient and their professional advisers only. It is intended to assist accounting professionals in forming their own advice to their clients. Use of and reliance on this information is the responsibility of the recipient. This document should not be reproduced or distributed to any other party without the prior written consent of Brevity Co Pty Ltd.*

### Professional review required

*The content of this document should be confirmed by a qualified professional with reference to the specific facts and circumstances of the matter before any action is taken.*

*Liability limited by a scheme approved under Professional Standards Legislation.*

## Document Version Control

Item	Detail
Version	1.0
Date	March 2026