Status: **legally binding**

Product Ruling

Challenger Life Company Limited – CarePlus

Relying on this Ruling

This publication (excluding appendix) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

If this Ruling applies to you, and you correctly rely on it, we will apply the law to you in the way set out in this Ruling. That is, you will not pay any more tax or penalties or interest in respect of the matters covered by this Ruling.

Terms of use of this Ruling

This Ruling has been given on the basis that the entity who applied for the Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Ruling.

Changes in the law

Product Rulings were introduced for the purpose of providing certainty about tax consequences for entities in schemes such as this. In keeping with that intention, the Commissioner suggests promoters and advisers ensure that participants are fully informed of any legislative changes after the Ruling has issued. Similarly, entities that are considering participating in the Scheme are advised to confirm with their tax adviser that changes in the law have not affected this Ruling since it was issued.

No guarantee of commercial success

The Commissioner does not sanction or guarantee this product. Further, the Commissioner gives no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential participants must form their own view about the commercial and financial viability of the product. The Commissioner recommends a financial (or other) adviser be consulted for such information.

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What this Ruling is about

1. This Ruling sets out the income tax consequences for entities referred to in paragraph 4 of this Ruling in connection with an investment in Challenger CarePlus (CarePlus) issued by Challenger Life Company Limited (Challenger) under a Product

Status: **legally binding**

Disclosure Statement dated 27 September 2021. CarePlus is comprised of 2 products, being CarePlus Annuity (Annuity) and CarePlus Insurance (Insurance).

2. All legislative references in this Ruling are to the *Income Tax Assessment Act 1936*, unless otherwise indicated.

3. This Ruling does not address:

- the tax consequences
  - of acquiring and holding the Annuity and Insurance, other than as per paragraphs 10 to 33 of this Ruling
  - from disposing or otherwise ending the Annuity other than by voluntary withdrawal or upon death within the withdrawal period
  - from disposing or otherwise ending the Insurance other than by voluntary cancellation or upon death
  - for an Annuity and Insurance purchased using a directed termination payment within the meaning of the *Income Tax (Transitional Provisions) Act 1997* (IT(TP)A 1997)
  - for an Annuity and Insurance purchased using personal injury compensation money, as per Division 54 of the *Income Tax Assessment Act 1997* (ITAA 1997)
  - of borrowing funds to purchase the Annuity and Insurance, including the deductibility of interest on funds borrowed
- a policy owner's eligibility to claim the seniors and pensioners tax offset
- the deductibility of the amount invested to purchase the Annuity[1]
- whether the regular payments made by Challenger to the policy owner under the Annuity are subject to pay as you go withholding
- the treatment of any duties, fees, tax or other government charges that may be deducted from the funds to purchase the Annuity and Insurance, sum insured or the termination value payable by Challenger under the Insurance or Annuity, and
- the deductibility of adviser service fees.

Who this Ruling applies to

4. This Ruling applies to you if you are an Australian resident for tax purposes and are one of the following:

- an individual policy owner (other than in the capacity of a trustee of a trust estate) who purchases the Annuity and Insurance described in paragraphs 10 to 33 of this Ruling on or after 1 July 2025 and on or before 30 June 2028, referred to as policy owner in this Ruling, or

[1] For the purposes of this Ruling, it is assumed at subparagraph 9(e) that no portion of the CarePlus investment amount invested to purchase the Annuity is deductible.

- where the policy owner referred to in this paragraph dies without having voluntarily withdrawn their Annuity (within the withdrawal period) or having voluntarily cancelled their Insurance
  - an individual (other than in the capacity of a trustee of a trust estate) nominated as a beneficiary by the policy owner, or
  - the trustee of the deceased estate of the policy owner.

5. This Ruling does not apply to you if you:

- purchase the Annuity and Insurance before 1 July 2025 or after 30 June 2028
- purchase the Annuity and Insurance using
  - a directed termination payment within the meaning of the IT(TP)A 1997
  - a personal injury compensation money that is subject to Division 54 of the ITAA 1997, or
  - superannuation contributions[2] or pensions, or
- are not at least one of the entities listed in paragraph 4 of this Ruling.

Date of effect

6. This Ruling applies from 1 July 2025 to the entities specified in paragraph 4 of this Ruling in connection with an Annuity and Insurance purchased from 1 July 2025 until 30 June 2028.

7. However, the Ruling only applies and may be relied on to the extent that there is no change in the scheme or in the entity's involvement in the scheme. If the scheme carried out is materially different from the Scheme described at paragraphs 10 to 33 of this Ruling, this Ruling cannot be relied upon and may be withdrawn or modified.

Ruling

8. Subject to paragraph 3 of this Ruling and the assumptions in paragraph 9 of this Ruling:

(a) Sub-subparagraphs 8(a)(i) to (ix) of this Ruling relate to the CarePlus Annuity.

(i) An Annuity purchased by the policy owner is

- not a 'qualifying security' as defined in subsection 159GP(1)
- not a 'superannuation income stream' as defined in section 307-70.02 of the *Income Tax Assessment (1997 Act) Regulations 2021* (ITAR (1997) 2021), and
- an 'annuity' as defined in subsection 27H(4).

[2] The term 'contribution' in the superannuation context is defined in paragraph 4 of Taxation Ruling TR 2010/1 *Income tax: superannuation contributions*.

(ii) An Annuity purchased by the policy owner is not a financial arrangement to which Division 230 of the ITAA 1997 applies.

(iii) The regular payments made by Challenger to the policy owner are assessable income under subsection 27H(1) to the extent that the regular payments exceed the 'deductible amount' in relation to the Annuity. The deductible amount is excluded from the assessable amount of the Annuity.

(iv) The annual deductible amount in relation to the regular payments derived by the policy owner is ascertained (subject to subsection 27H(3)) in accordance with the formula set out in subsection 27H(2) on the basis that the

- 'relevant share' in relation to the Annuity is one
- 'undeducted purchase price' of the Annuity is the amount paid to purchase the Annuity
- 'residual capital value' in relation to the Annuity is nil, and
- 'relevant number' in relation to the Annuity is the life expectation factor of the life insured (that is, the policy owner), determined on the commencement date of the Annuity in accordance with the prescribed Australian Life Tables.

(v) Where the regular payments are not payable to the policy owner for the whole of an income year, the deductible amount for that year will be reduced proportionately by the Commissioner pursuant to subsection 27H(3) based on the part of the year during which the regular payments are not paid.

(vi) The amount of any reduction in the deductible amount described in sub-subparagraph 8(a)(v) of this Ruling can be applied to regular payments derived by the policy owner in subsequent income years to the extent that those regular payments would otherwise exceed the deductible amount in those years.

(vii) Any capital gain made by the policy owner resulting from the regular payments made by Challenger is disregarded under section 118-300 of the ITAA 1997, and is not otherwise assessable as ordinary or statutory income under the ITAA 1997.

(viii) Any capital gain made by a policy owner resulting from the payment of the withdrawal value by Challenger to them upon commutation is disregarded under section 118-300 of the ITAA 1997. The payment of the withdrawal value in these circumstances is, however, included in the assessable income of the policy owner to the extent that it exceeds a capital component calculated as the undeducted purchase price (as per sub-subparagraph 8(a)(iv) of this Ruling) less any deductible amounts previously applied to the regular payments from the Annuity, but not reduced to less than zero.

(ix) Any capital gain made by a nominated beneficiary of the policy owner or the trustee of the deceased estate of the policy owner, as applicable, resulting from the payment of a death benefit by Challenger to them upon death is disregarded under section 118-300 of the ITAA 1997. The payment of the death benefit in these

circumstances is, however, included in the assessable income of such nominated beneficiary or the deceased estate, as applicable, to the extent that it exceeds a capital component calculated as the undeducted purchase price (as per sub-subparagraph 8(a)(iv) of this Ruling) less any deductible amounts previously applied to the regular payments from the Annuity, but not reduced to less than zero.

(b) Sub-subparagraphs 8(b)(i) to (v) of this Ruling relate to the CarePlus Insurance.

(i) The premium paid by the policy owner to purchase the Insurance is not deductible under section 8-1 of the ITAA 1997.

(ii) The payment of the termination value by Challenger to the policy owner upon cancellation of their Insurance is not included in the assessable income of the policy owner pursuant to sections 6-5 or 230-15 of the ITAA 1997, or sections 26AH, 27H or 159GQ.

(iii) Any capital gain or capital loss made by the policy owner resulting from the payment of the termination value by Challenger to them upon cancellation of their Insurance is disregarded under section 118-300 of the ITAA 1997.

(iv) The payment of the sum insured by Challenger to the nominated beneficiary or the deceased estate of the policy owner, as applicable, upon the death of the policy owner is not included in their assessable income pursuant to sections 6-5 or 230-15 of the ITAA 1997, or sections 26AH, 27H or 159GQ.

(v) Any capital gain or capital loss made by the nominated beneficiary or the deceased estate of the policy owner, as applicable, resulting from the payment of the sum insured by Challenger to them upon the death of the policy owner is disregarded under section 118-300 of the ITAA 1997.

(c) Provided the scheme ruled on is entered into and carried out as described in this Ruling, the anti-avoidance provisions in Part IVA will not apply to the entities referred to in paragraph 4 of this Ruling.

Assumptions

9. This Ruling is made on the basis of the following necessary assumptions:

(a) The policy owner and any nominated beneficiary are individual Australian residents for tax purposes and are not a tax resident of a country with which Australia has concluded a double-tax treaty.

(b) The policy owner's deceased estate is an Australian-resident trust estate as defined in subsection 95(2) and are not a resident trust estate of a country with which Australia has concluded a double-tax treaty.

(c) The policy owner will not purchase the Annuity using a directed termination payment within the meaning of the IT(TP)A 1997, or using personal injury compensation money that is subject to Division 54 of the ITAA 1997.

(d) The policy owner is the original policy owner who purchased the Annuity and Insurance from Challenger for their own benefit.

(e) No portion of the CarePlus investment amount to purchase the Annuity is deductible.

(f) All dealings between Challenger, the policy owner and their nominated beneficiary or deceased estate will be at arm's length.

(g) The scheme will be executed in the manner described in the Scheme section of this Ruling and the Product Disclosure Statement referred to in paragraph 10 of this Ruling.

Scheme

10. The scheme is identified and described in the following:

- application for a product ruling received on 26 March 2025, and
- Challenger CarePlus Product Disclosure Statement dated 27 September 2021, including the CarePlus Annuity Policy Document and the CarePlus Insurance Policy Document.

Note: certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under freedom of information legislation.

11. For the purposes of describing the scheme, there are no other agreements (whether formal or informal, and whether or not legally enforceable) which the policy owner, their nominated beneficiary or deceased estate, or any associate of such entity, will be a party to which are a part of the scheme.

12. All Australian Securities and Investments Commission requirements are, or will be, complied with for the term of the agreements.

Overview of scheme

13. Challenger has issued CarePlus, comprised of 2 products, the Annuity and the Insurance. Each product can only be purchased:

- in Australia, by an individual over 18 years of age receiving, or planning to receive, Government-subsidised aged care services, and
- at the same time as the other product.

14. To purchase the Annuity and the Insurance, the policy owner is required, among other things, to execute and lodge an application form with Challenger, together with an investment amount of at least $10,000. That investment amount (CarePlus investment amount) is the total of the purchase price paid by the policy owner to acquire the Annuity and the one-off premium paid by the policy owner to acquire the Insurance. No additional fees or charges (including premiums) are payable to Challenger by the policy owner for the duration of the policies.

15. The CarePlus investment amount cannot be funded using a 'roll-over superannuation benefit' (as defined in section 306-10 of the ITAA 1997), or jointly with another person.

16. Upon acceptance of a valid application, for each policy acquired the policy owner is issued with separate Policy Documents (each a legal contract between the policy owner and Challenger) and separate Investor Certificates by Challenger, setting out the relevant terms and conditions.

17. The life insured under both the Annuity and the Insurance is the policy owner.

CarePlus Annuity

18. The Annuity is a 'life policy' for the purposes of the *Life Insurance Act 1995* (as per paragraph 9(1)(c) of that Act) which therefore satisfies the definition of a 'life insurance policy' under subsection 995-1(1) of the ITAA 1997.

19. In exchange for the purchase price paid to purchase the Annuity and subject to the payment of a withdrawal value, the Annuity provides regular monthly payments for the policy owner's lifetime.

20. The amount of the regular payments is fixed for the duration of the policy, determined at the time the Annuity is purchased and depends on a number of factors, including the amount invested, prevailing market rates and the policy owner's life expectancy at the time of purchase.

21. The policy owner cannot add to the amount invested and the Annuity is not transferrable. The Annuity continues for the duration of the policy owner's life regardless of how long they live or how investment markets perform. Policy owners do not bear any market risk.

22. The regular payments under the Annuity do not include investment income or an accruals component from the investment of the purchase price provided by the policy owner for the Annuity.

23. The Annuity has a withdrawal period based on the policy owner's life expectancy (set out in the policy owner's CarePlus Annuity Investor Certificate). The policy owner has the right to withdraw their Annuity at any time during the withdrawal period and receive a withdrawal value, payable by Challenger as a lump sum.

24. The maximum withdrawal value payable by Challenger as a result of the policy owner's withdrawal starts at 100% of the amount invested in the Annuity and progressively reduces until it reaches zero at the end of the withdrawal period. The Annuity ceases to have a withdrawal value after the end of the withdrawal period.

25. The policy owner cannot partially withdraw the Annuity.

26. Where the policy owner dies within the withdrawal period, a death benefit equal to the maximum withdrawal value at that time will be paid as a lump sum to either the nominated beneficiary of the policy owner or, where a valid nomination has not been made, to the policy owner's deceased estate.

27. The Annuity will cease, together with the regular payments, on the death of the policy owner or the earlier withdrawal of the Annuity by the policy owner.

CarePlus Insurance

28. The Insurance is a 'life policy' for the purposes of the *Life Insurance Act 1995* (as per paragraph 9(1)(a) of that Act) which therefore satisfies the definition of a 'life insurance policy' under subsection 995-1(1) of the ITAA 1997.

29. Upon the death of the policy owner, Challenger will pay a lump sum amount (the sum insured) either to one or more beneficiaries nominated by the policy owner or, where a valid nomination has not been made, to the policy owner's deceased estate.

30. While the policy owner holds the Annuity, the sum insured equals the difference between the CarePlus investment amount and the death benefit payable under the Annuity

at the time. Where the Annuity has been withdrawn, the sum insured equals the difference between the CarePlus investment amount and the death benefit payable under the Annuity at the time the Annuity was withdrawn.

31. The sum insured payable under the Insurance does not include investment income or an accruals component from the investment of the premium or CarePlus investment amount.

32. The policy owner has the right to cancel their Insurance at any time. On voluntary cancellation, the policy owner will be paid a termination value[3] by Challenger, the calculation of which is subject to a minimum prescribed under the *Life Insurance Act 1995* and prudential standards enforced by the Australian Prudential Regulation Authority.

33. Cover under the Insurance will cease either on the death of the policy owner or the earlier voluntary cancellation of the policy by the policy owner.

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18 June 2025

[3] Stamp duty will be deducted from the sum insured or the termination value, as appropriate, before being distributed by Challenger, where the appropriate recipient resides in South Australia.

Status: **not legally binding**

Appendix – Explanation

This Explanation is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.

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CarePlus Annuity

Subsection 27H(4) – annuity

34. Subsection 27H(4) defines an 'annuity' to mean:

> … an annuity, a pension paid from a foreign superannuation fund (within the meaning of the *Income Tax Assessment Act 1997*) or a pension paid from a scheme mentioned in paragraph 290-5(c) of that Act, but does not include:
>
> (a) an annuity that is a qualifying security for the purposes of Division 16E; or
>
> (b) a superannuation income stream (within the meaning of the *Income Tax Assessment Act 1997*).

35. This definition encompasses an annuity on ordinary concepts, as contemplated within various judicial authorities and discussed in Taxation Ruling IT 2480 *Income tax: variable annuities*. An annuity on ordinary concepts is a contract under which a principal sum is converted into an income stream[4] of payments that are at least annual, fixed or variable in a way that is calculable, and which will continue to be paid for a fixed or determinable period.

36. The policy owner's CarePlus investment amount is applied to purchase the regular payments payable by Challenger under the terms of the Annuity, a contract between the policy owner and Challenger. Those regular payments are a series of periodic monthly payments, fixed at the time of purchase and (unless commuted earlier for the withdrawal value) continue for the life of the policy owner. The policy owner's ability to commute does not of itself result in the Annuity failing to be accepted as an annuity contract (see paragraph 25 of IT 2480).

37. An Annuity purchased by the policy owner therefore constitutes an annuity on ordinary concepts and, subject to the exclusions in paragraphs (a) and (b) of the definition (considered at paragraphs 38 to 43 of this Ruling), constitutes an annuity as defined in subsection 27H(4).

Division 16E – qualifying security

38. A 'qualifying security' is defined in subsection 159GP(1). For the purposes of determining whether an arrangement is a qualifying security, that arrangement must be a 'security', also defined in subsection 159GP(1) to mean:

(a) stock, a bond, debenture, certificate of entitlement, bill of exchange, promissory note or other security;

(b) a deposit with a bank or other financial institution;

(c) a secured or unsecured loan; or

(d) any other contract, whether or not in writing, under which a person is liable to pay an amount or amounts, whether or not the liability is secured.

39. The Annuity is not considered to have sufficient debt-like obligations to be a contract to which paragraph (d) of the definition of security in subsection 159GP(1) applies, nor does it fall within paragraphs (a), (b) or (c) of that definition. Therefore, the Annuity does not meet the definition of security under subsection 159GP(1) and, as such, is not a qualifying security for the purposes of Division 16E.

40. Additionally, an annuity will not be a qualifying security for the purposes of subsection 159GP(1) where it is an 'ineligible annuity', a term also defined in subsection 159GP(1) to include 'an annuity that is issued by a life assurance company to or for the benefit of a natural person other than in the capacity of trustee of a trust estate'. An Annuity issued by Challenger to the policy owner (that is, a natural person other than in the capacity of trustee of a trust estate) is an ineligible annuity.

Superannuation income stream

41. A 'superannuation income stream' has the meaning given by the ITAR (1997) 2021 (subsection 307-70(2) of the ITAA 1997). Subsection 307-70.02(1) of the ITAR

[4] The term 'income stream' is defined in paragraph 5 of Taxation Ruling TR 2013/5 *Income tax: when a superannuation income stream commences and ceases* in the context of a superannuation income stream as a payment by a superannuation fund trustee to a member as 'a series of periodic payments that relate to each other over an identifiable period of time'.

(1997) 2021 defines superannuation income stream in relation to an annuity commenced after 19 September 2007 to mean an income stream that is taken to be an annuity for the purposes of the *Superannuation Industry (Supervision) Act 1993* in accordance with subregulation 1.05(1) of the *Superannuation Industry (Supervision) Regulations 1994*.

42. Subregulation 1.05(1) of the *Superannuation Industry (Supervision) Regulations 1994* provides a number of requirements that must be met for a benefit provided by a life insurance company to be taken to be an annuity for the purposes of the *Superannuation Industry (Supervision) Act 1993*. One of those requirements in respect of a benefit purchased on or after 1 July 2007 is that it is purchased with the whole or part of a roll-over superannuation benefit as defined in section 306-10 of the ITAA 1997, or the whole or part of a directed termination payment within the meaning of the IT(TP)A 1997.

43. As per paragraph 15 of this Ruling, the policy owner cannot purchase the Annuity using a roll-over superannuation benefit as defined in section 306-10 of the ITAA 1997 and, as per subparagraph 9(c) of this Ruling, it is assumed for the purposes of this Ruling that the policy owner will not purchase the Annuity using a directed termination payment within the meaning of the IT(TP)A 1997. As such, the Annuity is not a superannuation income stream for the policy owner.

Division 230 of the ITAA 1997 – taxation of financial arrangements

44. Division 230 of the ITAA 1997 sets out the tax treatment of gains or losses from a 'financial arrangement'. Generally, a financial arrangement is a cash settlable legal or equitable right to receive a financial benefit, or obligation to provide such benefit, or a combination of one or more such rights or obligations (subsection 230-45(1) of the ITAA 1997). A right to receive or obligation to provide a financial benefit can be 'cash settlable' under subsection 230-45(2) of the ITAA 1997 if the benefit is money, or if it is a right the taxpayer intends to satisfy or settle by receiving money, or if it is an obligation that the taxpayer intends to satisfy or settle by providing money.

45. The Annuity constitutes a financial arrangement for the purposes of Division 230 of the ITAA 1997 on the basis that the policy owner has cash settlable rights to receive a financial benefit in the form of the regular payments or the withdrawal value, as applicable, and on the basis that the policy owner has a cash settlable obligation to provide a financial benefit in the form of the purchase price of the Annuity.

46. Subject to exceptions under Subdivision 230-H of the ITAA 1997, gains made from a financial arrangement are included in assessable income under subsection 230-15(1) of the ITAA 1997 and are not (to any extent) to be included in assessable income pursuant to any other taxing provision of the income tax Acts (subsection 230-20(4) of the ITAA 1997), including section 27H.

47. However, where the rights or obligations under an arrangement are the subject of an exception under section 230-460 of the ITAA 1997, Division 230 of the ITAA 1997 does not apply in relation to gains or losses from a financial arrangement for any income year (subsection 230-460(1) of the ITAA 1997). Subsection 230-460(5) of the ITAA 1997 provides a specific exception as follows:

> A right or obligation under a life insurance policy is the subject of an exception unless:
>
> (a) you are not a life insurance company that is the insurer under the policy; and
>
> (b) the policy is an annuity that is a qualifying security.

48. As the Annuity is a life insurance policy (as defined in subsection 995-1(1) of the ITAA 1997 and as per paragraph 18 of this Ruling) that is not a qualifying security (as defined in subsection 159GP(1) and discussed at paragraphs 38 to 40 of this Ruling), the

exception in subsection 230-460(5) of the ITAA 1997 applies and Division 230 of the ITAA 1997 does not apply to any gains or losses derived from an Annuity purchased by the policy owner.

Section 27H – assessability of regular payments

49. Paragraph 27H(1)(a) includes in the assessable income of a taxpayer of a year of income the amount of any annuity derived by the taxpayer during that year excluding, in the case of an annuity that has been purchased, any amount that is the deductible amount in relation to the annuity in relation to the year of income. The regular payments made by Challenger to the policy owner are therefore assessable income under subsection 27H(1) to the extent that the regular payments exceed the deductible amount in relation to the Annuity.

50. The deductible amount is excluded from the assessable amount of the annuity and is tax free to the recipient because it represents the return to them of the amount paid to acquire the annuity. Subsection 27H(2) provides for the calculation of the deductible amount in relation to an annuity derived by a taxpayer during a year of income, subject to subsections 27H(3) and (3A), in accordance with the following formula:

$$\frac{A\,(B\ -\ C)}{D}$$, where:

A is the relevant share in relation to the annuity in relation to the taxpayer in relation to the year of income.

B is the amount of the undeducted purchase price of the annuity.

C is:

(a) if there is a residual capital value in relation to the annuity and that residual capital value is specified in the agreement by virtue of which the annuity is payable or is capable of being ascertained from the terms of that agreement at the time when the annuity is first derived – that residual capital value, or

(b) in any other case – nil, and

D is the relevant number in relation to the annuity.

51. The relevant share in relation to the Annuity (component A) for the policy owner is one, in accordance with the definition of that term in subsection 27H(4).

52. The undeducted purchase price in relation to an Annuity (component B) that is purchased by the policy owner is the whole of the purchase price of the Annuity, reduced by any portion of the purchase price that is an allowable deduction. As per subparagraph 9(e) of this Ruling, it is assumed for the purposes of this Ruling that no portion of the amount invested to purchase the Annuity is deductible.

53. The residual capital value in relation to an annuity is defined in subsection 27H(4) as 'the capital amount payable on the termination of the annuity'. As the terms of the Annuity do not provide for any residual capital value in relation to the Annuity, it (component C) is nil.

54. Where an annuity is payable during the lifetime of a person and not thereafter, the relevant number in relation to that annuity in relation to a year of income is defined in subsection 27H(4) to include the life expectation factor of the person. The relevant number in relation to the Annuity (component D) is therefore the life expectation factor of the policy owner. The life expectation factor in relation to a person in relation to an annuity is defined in subsection 27H(4) to mean the number of years in the complete expectation of life of the

person as ascertained by reference to the prescribed Life Tables[5] at the time at the beginning of the period to which the first payment of the annuity relates.

55. Where we consider that the deductible amount ascertained in accordance with the formula in subsection 27H(2) is inappropriate, having regard to the terms and conditions applying to the annuity and to any other relevant matters, we may, subject to subsection 27H(3A), determine the deductible amount that applies pursuant to subsection 27H(3). In making a determination pursuant to subsection 27H(3), we may have regard to the terms and conditions applying to the annuity, to a certificate supplied by an actuary and to any other matters considered relevant.

56. Paragraphs 16 to 24 of Taxation Ruling IT 2157 *Income tax: assessment of annuities eligible termination payments – commutation of annuities – Commonwealth Superannuation Act* provide some guidelines as to the exercise of the discretion under subsection 27H(3). Applying those guidelines to the Annuity, we may exercise the discretion under subsection 27H(3) where the regular payments are not payable for the whole of an income year, in which case the deductible amount ascertained under subsection 27H(2) will be inappropriate and reduced proportionately based on the part of the year during which the regular payments are not paid.

57. As the Annuity cannot be partly commuted, subsection 27H(3A) cannot have any application on the determination of the deductible amount in relation to the Annuity.

Assessability of the withdrawal value and death benefit

58. The receipt of the withdrawal value from Challenger by a policy owner upon commutation of the Annuity, or receipt of the death benefit from Challenger by a nominated beneficiary or the trustee of a deceased estate, as applicable, on the death of a policy owner, is assessable income to the extent that it does not comprise a repayment of capital. The capital component of the withdrawal value and death benefit in these circumstances is the undeducted purchase price of the Annuity less any deductible amounts previously applied to the regular payments from the Annuity, but not reduced to less than zero.

59. Any amount referred to in paragraph 58 of this Ruling which is included in the assessable income of a trustee of a deceased estate shall be deemed to be income to which no beneficiary is presently entitled pursuant to subsection 101A(1).

Capital gain or capital loss from payments under the Annuity disregarded

60. Under subsection 108-5(1) of the ITAA 1997, a CGT asset is any kind of property or a legal or equitable right that is not property. The contractual rights of the policy owner and, as applicable, the policy owner's nominated beneficiary or deceased estate under the Annuity are legally enforceable rights and therefore a CGT asset according to the definition in subsection 108-5(1) of the ITAA 1997. Generally, the discharge or satisfaction of contractual rights give rise to a CGT event C2 (paragraph 104-25(1)(b) of the ITAA 1997).

61. Section 118-300 of the ITAA 1997 exempts certain capital gains and losses made in respect of a policy of insurance on the life of an individual or an annuity instrument. An annuity instrument is defined broadly in subsection 995-1(1) of the ITAA 1997 to mean an

[5] For the purposes of the definition of 'life expectation factor' in subsection 27H(4) and with respect to annuities first commencing to be payable on or after 1 July 1993, section 7 of the *Income Tax Assessment (1936 Act) Regulation 2015* prescribes the Australian Life Tables that are most recently published before the year in which the annuity first commences to be payable.

instrument that secures the grant of an annuity (whether dependent on the life of an individual or not).

Section 118-300 of the ITAA 1997 – regular payments

62. Table item 3 of subsection 118-300(1) of the ITAA 1997 provides that a capital gain or capital loss made from a CGT event happening in relation to a CGT asset that is an interest in rights under an annuity instrument is disregarded where that CGT event happens to the original owner of the instrument (other than the trustee of a complying superannuation entity).

63. As an individual to whom the Annuity is first issued, the policy owner is regarded as an original owner of an annuity instrument. Pursuant to table item 3 of subsection 118-300(1) of the ITAA 1997, any capital gain or capital loss the policy owner makes under section 104-25 of the ITAA 1997 from the receipt of regular payments by Challenger under the Annuity is therefore disregarded.

Section 118-300 of the ITAA 1997 – payment of withdrawal value and death benefit

64. As a policy owner is regarded as an original owner of an annuity instrument, pursuant to table item 3 of subsection 118-300(1) of the ITAA 1997 they will disregard any capital gain or capital loss they make under section 104-25 of the ITAA 1997 from the receipt of the withdrawal value from Challenger upon commutation of the Annuity.

65. Table item 4 of subsection 118-300(1) of the ITAA 1997 provides that a capital gain or capital loss made from a CGT event happening in relation to a CGT asset that is an interest in rights under an annuity instrument is disregarded where that CGT event happens to an entity that acquired that interest in the instrument for no consideration.

66. A nominated beneficiary of the policy owner or the trustee of the deceased estate of the policy owner (as applicable) acquires, on the death of the policy owner, an interest in the Annuity for no consideration and will, therefore, pursuant to table item 4 of subsection 118-300(1) of the ITAA 1997, disregard any capital gain or capital loss they make under section 104-25 of the ITAA 1997 from the receipt of the death benefit from Challenger upon the death of the policy owner.

CarePlus Insurance

Premium not deductible

67. The question of whether a premium is deductible is answered by reference to whether the benefits, when paid, would be assessable. In discussing the operation of former subsection 51(1) (being the equivalent of section 8-1 of the ITAA 1997) in the High Court decision of *Commissioner of Taxation (Cth) v Smith* [1981] HCA 10, Gibbs, Stephen, Mason and Wilson JJ held that:

> What is incidental and relevant in the sense mentioned falls to be determined not by reference to the certainty or likelihood of the outgoing resulting in the generation of income but to its nature and character, and generally to its connexion with the operations which more directly gain or produce the assessable income. It is true that the payment of the premium in June 1978 did not result in the generation of any income in that year, but there is a sufficient connexion between the purchase of the cover against the loss of ability to earn and the consequent earning of assessable income to bring the premium within the first limb of s 51(1).

68. Murphy J delivered a separate judgment but concurred with the view of the majority and stated:

> In general, if receipts under such a policy would be treated as income, the premiums should be treated as allowable expenditure, and if the receipts would be treated as capital the premiums should not be allowable expenditure.

69. As the payment of the sum insured under the Insurance is intended to compensate for the loss of the life insured it is treated as capital (see paragraphs 71 to 73 of this Ruling). The premium is therefore not incurred in gaining or producing assessable income and is not deductible under section 8-1 of the ITAA 1997.

Payment of the sum insured not assessable as ordinary income under section 6-5 of the ITAA 1997

70. Section 6-5 of the ITAA 1997 includes income according to ordinary concepts (ordinary income) in assessable income. Income according to ordinary concepts refers to an accepted usage of the word 'income' and income that Courts have determined is ordinary income.

71. The characterisation to be accorded to the sum insured payable under the Insurance will depend on the purpose of the payment and the circumstances of its receipt: *Tinkler v Commissioner of Taxation* [1979] FCA 136, per Brennan J. Under the Insurance, the policy owner takes out a policy with the intention for their nominated beneficiary or deceased estate to receive the sum insured on the happening of the death of the policy owner. The sum insured is intended to compensate the policy owner's nominated beneficiary or deceased estate, as applicable, for the loss of the policy owner (as the life insured).

72. Ordinarily, the receipt of insurance proceeds in the form of a lump sum would not come within the term of ordinary income where the payment has been made in the event of death or for deprivation or impairment of earning capacity (refer to *The Commissioner of Taxation of the Commonwealth of Australia v Slaven, Robyn Leanne* [1984] FCA 17). Such payments are capital in nature.

73. Accordingly, the payment of the sum insured under the Insurance to the nominated beneficiary or the deceased estate of the policy owner, as applicable, is a capital receipt, and is not assessable under section 6-5 of the ITAA 1997 as ordinary income.

Payment of the termination value not assessable as ordinary income under section 6-5 of the ITAA 1997

74. Ordinary income has generally been held to include 3 categories, namely income from services rendered, income from property and income from carrying on a business. Other characteristics of ordinary income that have evolved from judicial authority include receipts that are earned, expected, relied upon, and have an element of periodicity, recurrence or regularity.

75. The payment of the termination value (a lump sum) to the policy owner on voluntary cancellation of their Insurance does not relate to any of the 3 categories identified in paragraph 74 of this Ruling. While the termination value can be said to be expected and may be relied upon, it is not earned, and does not have an element of periodicity, recurrence or regularity.

76. Accordingly, the payment of the termination value under the Insurance to the policy owner, a receipt which relates to the personal circumstances of the policy owner, is not assessable under section 6-5 of the ITAA 1997 as ordinary income.

Payments under the Insurance not assessable under section 230-15 of the ITAA 1997

77. The Insurance constitutes a financial arrangement for the purposes of Division 230 of the ITAA 1997 on the basis that the policy owner or the nominated beneficiary or deceased estate of the policy owner have cash settlable rights to receive a financial benefit in the form of the termination value and the sum insured, as appropriate, on the happening of a specified event, and on the basis that the policy owner has a cash settlable obligation to provide a financial benefit in the form of the premium.

78. Subject to exceptions under Subdivision 230-H of the ITAA 1997, gains made from a financial arrangement are included in assessable income under subsection 230-15(1) of the ITAA 1997.

79. As the Insurance is a life insurance policy (as defined in subsection 995-1(1) of the ITAA 1997 and as per paragraph 28 of this Ruling) that is not an annuity that is a qualifying security (as discussed at paragraphs 87 to 90 of this Ruling), the exception in subsection 230-460(5) of the ITAA 1997 applies and Division 230 of the ITAA 1997 does not apply to any gains or losses derived by the policy owner from the voluntary cancellation of their Insurance, or by the policy owner's nominated beneficiary or deceased estate upon the death of the policy owner.

Payments under the Insurance not assessable under section 26AH

80. Subsection 26AH(6) includes all or part of amounts received as or by way of bonuses under certain life assurance policies[6], which but for section 26AH would not be included in the assessable income of the recipient, in the assessable income of the recipient when received within 10 years of the date on which the first or only premium paid under the policy was paid.

81. The term 'bonus' is not defined for the purposes of section 26AH but is explained at paragraph 8 of Taxation Ruling IT 2346 *Income tax: bonuses paid on certain life assurance policies – section 26AH – interpretation and operation* in the context of 'more traditional policies' as a guaranteed addition to the amount insured, payable when the amount insured is payable and representing both a form of participation by the policy holder in the issuing company's profits and a share in the surpluses derived by the issuing company during the period the policy is in force. Relevantly, the Prudential Standards similarly define the term 'bonus' at CPS 001 to mean 'an amount of profit added at the discretion of a life company (including additions in respect of investment experience) to the benefits due under a participating benefit but excluding any guaranteed rate of addition also applicable to the benefit'.

82. As the payment of the termination value to the policy owner upon voluntary cancellation of their Insurance will equate to the minimum surrender value prescribed under the *Life Insurance Act 1995* and Australian Prudential Regulation Authority prudential standards, and will not contain any element of profit of Challenger, the termination value cannot be characterised as a bonus.

[6] A life assurance policy is defined in section 6 as having the meaning given to 'life insurance policy' by the ITAA 1997.

83. Similarly, as the payment of the sum insured to either the policy owner's nominated beneficiary or deceased estate, as applicable, is the payment of a predetermined amount due under the Insurance upon the death of the policy owner, and will not contain any element of profit of Challenger, the sum insured cannot be characterised as a bonus. Furthermore, subsection 26AH does not apply to include in assessable income an amount received under a life assurance policy in consequence of the death of the person insured (paragraph 26AH(7)(a)).

84. For the reasons stated in paragraphs 82 and 83 of this Ruling, subsection 26AH(6) does not apply to include either the termination value or the sum insured in the assessable income of the recipient.

Payments under the Insurance not assessable under section 27H

85. As per paragraph 49 of this Ruling, section 27H includes in assessable income the amount of any annuity derived by the taxpayer for the year excluding, where it has been purchased, the deductible amount.

86. Paragraphs 34 and 35 of this Ruling set out what constitutes an annuity for the purposes of section 27H. The payments of the termination value or the sum insured under the Insurance are not an annuity and will not be assessable to either the policy owner or their nominated beneficiary or deceased estate, as applicable, under section 27H.

Payments under the Insurance not subject to the 'accruals assessability' under Division 16E

87. Division 16E was enacted to prevent tax deferral opportunities which were available from certain discounted and deferred interest securities that satisfy the definition of a 'qualifying security'. Under Division 16E, the income and deductions from these qualifying securities are spread over the term of the security on a basis which reflects the economic gains and losses which have accrued at any point in time.

88. As mentioned in paragraph 38 of this Ruling, for the purposes of determining whether an arrangement is a qualifying security as defined in subsection 159GP(1), that arrangement must be a security, also defined in subsection 159GP(1).

89. The Insurance is not considered to have sufficient debt-like obligations to be a contract to which paragraph (d) of the definition of security in subsection 159GP(1) applies, nor does it fall within paragraphs (a), (b) or (c) of that definition. Therefore, the Insurance does not meet the definition of security under subsection 159GP(1) and, as such, is not a qualifying security for the purposes of Division 16E.

90. As the Insurance is not a qualifying security, Division 16E has no application and no part of the termination value or the sum insured is assessable on an accruals basis under section 159GQ.

Capital gain or capital loss from payments under the Insurance disregarded

91. The contractual rights of the policy owner and, as applicable, the policy owner's nominated beneficiary or deceased estate under the Insurance are legally enforceable rights and therefore a CGT asset according to the definition in subsection 108-5(1) of the ITAA 1997.

92. Where Challenger makes a payment of the termination value in satisfaction of the policy owner's contractual rights under the Insurance, their ownership of those rights are

discharged or satisfied. Similarly, where Challenger makes a payment of the sum insured in satisfaction of the nominated beneficiary's or policy owner's deceased estate's contractual rights under the Insurance, as applicable, their ownership of those rights are discharged or satisfied. This discharge or satisfaction of the contractual rights gives rise to CGT event C2 (paragraph 104-25(1)(b) of the ITAA 1997).

93. The policy owner, their nominated beneficiary or their deceased estate, as applicable, makes a capital gain from this CGT event if their capital proceeds from the ending of the ownership of their asset are more than the asset's cost base or a capital loss if those capital proceeds are less than the asset's reduced cost base (subsection 104-25(3) of the ITAA 1997).

94. Section 118-300 of the ITAA 1997 exempts certain capital gains and losses made in respect of a policy of insurance on the life of an individual. The meaning to be given to the expression 'policy of insurance on the life of an individual' includes, but is not limited to, life insurance policies within the common law meaning of that term. It can apply to other life insurance policies as defined in subsection 995-1(1) of the ITAA 1997 but only to the extent that those policies provide for a sum of money to be paid if an event happens that results in the death of an individual (Taxation Determination TD 2007/4 *Income tax: capital gains tax: is a 'policy of insurance on the life of an individual' in section 118-300 of the Income Tax Assessment Act 1997 limited to a life insurance policy within the common law meaning of that expression?*).

95. Table item 3 of subsection 118-300(1) of the ITAA 1997 provides that a capital gain or capital loss made from a CGT event happening in relation to a CGT asset that is an interest in rights under a life insurance policy is disregarded where that CGT event happens to the original owner of the policy (other than the trustee of a complying superannuation entity).

96. As an individual to whom the Insurance is first issued, the policy owner is regarded as an original owner of a policy of insurance on the life of an individual. Accordingly, the policy owner will be entitled under table item 3 of subsection 118-300(1) of the ITAA 1997 to disregard any capital gain or capital loss they make under section 104-25 of the ITAA 1997 from the receipt of a payment of the termination value by Challenger upon voluntary cancellation of the Insurance.

97. Table item 4 of subsection 118-300(1) of the ITAA 1997 provides that a capital gain or capital loss made from a CGT event happening in relation to a CGT asset that is an interest in rights under a life insurance policy is disregarded where that CGT event happens to an entity that acquired the interest in the policy for no consideration.

98. The policy owner's deceased estate or a beneficiary nominated by the policy owner to receive the sum insured in the event of the death of the policy owner, as applicable, acquires on the death of the policy owner an interest in the Insurance for no consideration. The deceased estate or the nominated beneficiary, as applicable, will therefore be entitled under table item 4 of subsection 118-300(1) of the ITAA 1997 to disregard any capital gain or capital loss they make under section 104-25 of the ITAA 1997 from the receipt of a payment of the sum insured by Challenger upon the policy owner's death.

Status: **not legally binding**

References

Related rulings and determinations:

IT 2157; IT 2346; IT 2480; TD 2007/4; TR 2010/1; TR 2013/5

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