PR 2007/20 - Income tax: ING Life Limited - OneCare Policy - Life Cover, Total and Permanent Disability Cover and/or Trauma Cover

Product Ruling

Income tax: ING Life Limited – OneCare Policy – Life Cover, Total and Permanent Disability Cover and/or Trauma Cover

Contents Para

This publication provides you with the following level of protection:

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

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (or in a way that is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

No guarantee of commercial success

The Tax Office **does not** sanction or guarantee this product. Further, we give 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. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential participants by confirming that the tax benefits set out in the **Ruling** part of this document are available, **provided that** the scheme is carried out in accordance with the information we have been given, and have described below in the **Scheme** part of this document. If the scheme is not carried out as described, participants lose the protection of this Product Ruling.

Terms of use of this Product Ruling

This Product Ruling has been given on the basis that the entity(s) who applied for the Product 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 Product Ruling.

What this Ruling is about

1. This Product Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified in the Ruling part apply to the defined class of entities who participate in the scheme to which this Product Ruling relates.

2. In this Product Ruling, the scheme involves the payment of insurance benefits in accordance with the 'instalment benefit payment type' (monthly instalment benefit) to individual persons who are policy owners, or their nominated beneficiaries, under the OneCare Policy offered by ING Life Limited (ING Life) in respect of Life Cover, Total and Permanent Disability (TPD) Cover and/or Trauma Cover.

Class of entities

3. The class of entities who can rely on this Product Ruling is:

- individuals (not acting in a trustee capacity) who are issued with a OneCare Policy by ING Life, and individuals (not acting in a trustee capacity) nominated as beneficiaries by such policy owners, who are entitled to receive an insurance settlement in respect of Life Cover, where:
  - (a) the settlement is required to be paid in instalments over a period (referred to as an 'instalment benefit payment type');
  - (b) the insurance cover does not represent 'key man' and other similar insurance covered by Taxation Ruling No. IT 155; and
  - (c) the policy does not support a 'buy/sell', share purchase or business succession agreement, and
- individuals (not acting in a trustee capacity) who are issued with a OneCare Policy by ING Life who are entitled to receive an insurance settlement in respect of TPD Cover or Trauma Cover where:
  - (a) the settlement is required to be paid in instalments over a period (referred to as an 'instalment benefit payment type');
  - (b) the policy owner and the life insured are the same or, if they are not, the life insured is a 'relative' of the policy owner (as defined in subsection 995-1(1) of the *Income Tax Assessment Act 1997* (ITAA 1997));
  - (c) the insurance cover does not represent 'key man' and other similar insurance covered by Taxation Ruling No. IT 155; and
  - (d) the policy does not support a 'buy/sell', share purchase or business succession agreement.

4. However this Ruling does not apply to the following benefits and options available at extra cost under the OneCare Policy:

- Limited Death Benefit (under TPD and Trauma Cover);
- Accommodation Benefit;
- Financial Advice Benefit;
- Business Debt Protector;
- Premium Waiver Disability Option;
- Business Guarantee Option; and
- Life Cover Purchase Option.

Qualifications

5. The class of entities defined in this Product Ruling may rely on it provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 16 to 32 of this Ruling.

6. If the scheme actually carried out is materially different from the scheme that is described in this Product Ruling, then:

- this Product Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Product Ruling may be withdrawn or modified.

Date of effect

8. This Product Ruling applies prospectively from 28 March 2007, the date this Ruling is published. It therefore applies to the specified class of entities that enter into the scheme from 28 March 2007 until 30 June 2010, being its period of application. This Product Ruling will continue to apply to those entities even after its period of application for schemes entered into during the period of application.

9. However, the Product Ruling only applies to the extent that:

- there is no change in the scheme or in the entity's involvement in the scheme;
- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

10. If this Product Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

11. If this Product Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Product Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Changes in the law

12. Although this Product Ruling deals with the laws enacted at the time it was issued, later amendments may impact on this Product Ruling. Any such changes will take precedence over the application of the Ruling and, to that extent, this Product Ruling will have no effect.

13. Entities who are considering participating in the scheme are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Note to promoters and advisers

14. 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 Tax Office suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Product Ruling is issued.

Ruling

15. Subject to paragraph 3 of this Ruling:

(a) Monthly payments received by a policy owner under the Life Cover, TPD Cover and/or Trauma Cover, or by a nominated beneficiary under the Life Cover, under the 'instalment benefit payment type' will not be included in the assessable income of the policy owner or beneficiary in any year of income under section 6-5 of the ITAA 1997.

(b) Monthly payments received by a policy owner under the Life Cover, TPD Cover and/or Trauma Cover, or by a nominated beneficiary under the Life Cover, under the 'instalment benefit payment type' will not be included in the assessable income of the policy owner or nominated beneficiary in any year of income under section 27H of the *Income Tax Assessment Act 1936* (ITAA 1936).

(c) Monthly payments received by a policy owner under the Life Cover, TPD Cover and/or Trauma Cover, or by a nominated beneficiary under the Life Cover, under the 'instalment benefit payment type' will not be included in the assessable income of the policy owner or beneficiary in any year of income under section 15-30 of the ITAA 1997.

(d) No part of the monthly payments received by a policy owner under the Life Cover, TPD Cover and/or Trauma Cover, or by a nominated beneficiary under the Life Cover under the 'instalment benefit payment type' will be included in the assessable income of the policy owner or beneficiary in any year of income under section 159GQ of the ITAA 1936.

(e) A capital gain or loss made by a policy owner as a result of ING Life making an instalment benefit payment for TPD Cover or Trauma Cover will be disregarded under paragraph 118-37(1)(b) of the ITAA 1997 if the life insured is the policy owner, or if the life insured and the policy owner are not the same and the life insured is a relative of the policy owner within the meaning of 'relative' in subsection 995-1(1) of the ITAA 1997.

(f) A capital gain or loss made by a policy owner, or nominated beneficiary, as a result of ING Life making an instalment benefit payment in respect of Life Cover will be disregarded under section 118-300 of the ITAA 1997.

(g) No deduction under section 8-1 of the ITAA 1997 will be available to a policy owner for premiums incurred in respect of Life Cover, TPD Cover and/or Trauma Cover.

Scheme

16. The scheme that is the subject of this Product Ruling is described below. The scheme is incorporated within the following documents:

- Application for a Product Ruling dated 9 October 2006 received from Ernst and Young on behalf of ING Life;
- Product Disclosure Statements for Life Cover, TPD Cover and/or Trauma Cover issued by ING Life under the OneCare Policy; and
- OneCare Policy Terms.

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

17. For the purposes of describing the scheme to which this Product Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a policy owner or any associate of a policy owner, will be a party to, which are a part of the scheme. The effect of these agreements is summarised as follows.

Overview

18. ING Life offers a policy named 'OneCare'. The OneCare Policy offers a range of insurance covers, including:

- Life;
- TPD; and
- Trauma.

19. The benefits under the OneCare Policy, referred to as the 'insured amount', are paid:

- for Life Cover, when the life insured dies or is terminally ill;[1]

[1] Terminal illness means an illness that, in the opinion of an appropriate specialist physician approved by ING Life, is likely to lead to the death of the insured within 12 months.

- for TPD Cover, when the life insured becomes totally and permanently disabled; and
- for Trauma Cover, when the life insured suffers a specified trauma condition.

20. The 'insured amount' is an amount agreed between the policy owner and ING Life payable upon the happening of a specified event. The 'insured amount' payable under the Life, TPD and Trauma Covers does not include investment income or an accruals component from the investment of the premium.

21. A feature of the OneCare Policy is the requirement on the policy owner to nominate one of the two benefit payment types that is to apply should the insured amount become payable under the Life, TPD or Trauma Covers. These are either the 'instalment benefit payment type' or the 'lump sum benefit payment type'.

22. The benefit payment type can be changed upon request, but subject to ING Life's agreement. The benefit payment type however, cannot be changed at the time of a claim or at any time when entitlement to make a claim arises.

23. Where the 'instalment benefit payment type' has been selected, ING Life is required to pay the 'insured amount' on a monthly basis over a payment term specified in number of years (for example, 3, 5 or 10 years), or age based (payment term calculated by reference to age).

24. Under the 'lump sum benefit payment type' ING Life is required to pay the 'insured amount' in one payment.

25. As the 'insured amount' is an agreed amount the monthly payments under the 'instalment benefit payment type' do not entitle the policy owner to any capital indexation.

26. Under the Life Cover, where the policy owner and the life insured are the same, the policy owner can nominate a beneficiary to receive the insured amount in the event of the policy owner's death. If no beneficiary is nominated, the insured amount is paid to the policy owner's estate.

27. A OneCare Policy can be continued each year upon the payment of premiums.

28. The Life Cover, TPD Cover, and Trauma Cover do not have a surrender value.

The participants

29. ING Life is the insurance company which issues the Life Cover, the TPD Cover and Trauma Cover under the OneCare Policy.

30. The policy owners are individual persons who have been issued with a OneCare policy in respect of Life Cover, TPD Cover or Trauma Cover.

31. The nominated beneficiaries are persons named under the Life Cover as beneficiaries by the policy owner.

Assumptions

32. The policy owner and nominated beneficiary are Australian residents for taxation purposes.

Commissioner of Taxation
28 March 2007

Appendix 1 – Explanation

This Appendix 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.

Payments under the 'instalment benefit payment type' not assessable as ordinary income

33. Section 6-5 of the ITAA 1997 includes income according to ordinary concepts (ordinary income) in assessable income.

34. Income according to ordinary concepts refers to an accepted usage of the word 'income' and income that Courts have determined is ordinary income.

35. Ordinarily, insurance proceeds received 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: *Federal Commissioner of Taxation v. Slaven* 1 FCR 11; 15 ATR 242; 84 ATC 4077 (*Slaven*). Income Tax Ruling IT 2193 and Class Ruling CR 2005/15 confirm the capital characterisation of such payments. The exception, however, is where the insurance proceeds have been received to replace lost earnings: *Federal Commissioner of Taxation v. DP Smith* (1981) 147 CLR 578; 11 ATR 538; 81 ATC 4114 (*DP Smith*). Under the OneCare Policy the lump sum payable under the Life, TPD and Trauma Covers is intended not to compensate for the loss of earnings but for the loss of earning capacity of the insured, and would therefore not be ordinary income.

36. Whether the option to convert the lump sum payment into regular or periodic payments alters the character of the receipts requires further consideration. While periodicity or recurrence of payments is indicative that a series of payments is ordinary income, it is not definitive in classifying a series of payments: *Federal Commissioner of Taxation v. Dixon* (1952) 86 CLR 540; (1952) 10 ATD 82; (1952) 5 AITR 443 (*Dixon*) per Fullagar J at CLR 568; ATD 92; AITR 456.

37. The characterisation to be accorded to the payments under the 'instalment benefit payment type' will depend on the purpose of the payments and the circumstances of their receipt: *Tinkler v. Federal Commissioner of Taxation* (1979) 29 ALR 663; (1979) 10 ATR 411; 79 ATC 4641 per Brennan J at ALR 667; ATR 414; ATC 4644. Under the Life Cover, TPD Cover and Trauma Cover the policy owner takes out a policy with the intention to receive the insured amount on the happening of a specified event. The insured amount is intended not to compensate for the loss of earnings but for the loss of earning capacity of the insured.

38. The payments under the 'instalment benefit payment type' are distinguishable from the periodical payments received by the taxpayer in *Federal Commissioner of Taxation v. Inkster* (1989) 89 ALR 137; (1989) 20 ATR 1516, 89 ATC 5142 (*Inkster*) which the courts found to be assessable. In that case, the taxpayer received the periodical payments that had been 'intended to operate as a weekly amelioration of any realisation of his impaired capacity to earn a weekly income.' The payments, in effect, represented compensation to the taxpayer as provided for under the *Compensation (Commonwealth Government Employees) Act 1971*.

39. In Case X21, AAT case 5617 (1990) 21 ATR 3157; 90 ATC 239 Deputy President Gerber, after examining the circumstances of the taxpayer in *Inkster*, and comparing that Compensation Act to the Western Australian counterpart, said at ATR 3160; ATC 242:

> I am therefore satisfied that the mechanics provided by the [Western Australia Compensation] Act for calculating compensation indicate that the compensation payable is directly related to the amount of earnings which the employee would have been entitled to receive if he had been earning it in the form of wages. Compensation is thus a substitution for earnings and is paid for loss of earnings and assessable …

40. These cases highlight the requirement to give consideration to the instrument or contract that gives rise to the payment. This was also emphasised in *Slaven*, at FCR 22; ATR 253; ATC 4085:

> … the purpose of the statutory payment, as disclosed by the terms of the statute itself, must be a powerful, not conclusive, aid to the determination of the character of the payment and in particular as to whether it constitutes income in the hands of the taxpayer.

41. The calculation of the payments under the 'instalment benefit payment type' has no relationship to the amount of earnings of the policy owner.

42. The payments under the 'instalment benefit payment type' can also be distinguished from the insurance payments received by the taxpayer in *DP Smith*. In that case the taxpayer had taken out a personal disability insurance policy which was to 'provide a monthly indemnity against the income arising from the inability to earn': at CLR 584; ATR 541; ATC 4116. The payments under the 'instalment benefit payment type' are not paid to compensate for loss of earnings but for the loss of earning capacity.

43. The cited cases have been decided in accordance with the principle enunciated in *Dixon* that an amount paid in substitution for another amount takes the character of the substituted amount. Therefore, as the 'instalment benefit payment type' payments have been substituted for a capital payment they retain their capital characterisation.

44. Accordingly, the payments under the 'instalment benefit payment type' under the Life, TPD and/or Trauma Covers are capital receipts, and are not assessable under section 6-5 of the ITAA 1997.

45. The cited cases also provide support to treat the payments under the 'instalment benefit payment type' made to a nominated beneficiary under the Life Cover as not assessable under section 6-5 of the ITAA 1997.

Payments under the 'instalment benefit payment type' not an annuity

46. The conversion of the 'insured amount' into regular and periodic payments may place the policy owner, or the nominated beneficiary, in the position that an annuity may have been acquired with the lump sum payment with the outcome that the payments under the 'instalment benefit payment type' are assessable under section 27H of the ITAA 1936, notwithstanding that the payments are not assessable as ordinary income.

47. Section 27H of the ITAA 1936 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.

48. The word 'annuity' is defined in subsection 27H(4) of the ITAA 1936 to include:

> (a) a superannuation pension; and
>
> (b) a pension or annuity paid from a fund that is an eligible non-resident non-complying superannuation fund when the payment is made;
>
> but does not include an annuity that is a qualifying security for the purposes of Division 16E.

49. Paragraphs (a) and (b) of the definition, in this case, have no application. However, because the word 'includes' is used in the provision to define an 'annuity' the rule is for the word to take on its ordinary meaning, in addition to the meaning specified by the provision.

50. In *Scoble v. Secretary of State in Council for India* (1903) 1 KB 494 Mathew LJ stated at 504 that an annuity is:

> … the purchase of an income, and usually involves a change of capital into income, payable annually over a number of years.

51. Further, in *Watkins v. Deputy Commissioner of Taxation* (1946) 49 WALR 63; (1946) 3 AITR 263; (1946) 8 ATD 78 (*Watkins*) at WALR 67; AITR 264; ATD 79, Dwyer CJ stated that:

> 'Annuity' is a common term which was defined very long ago as 'A yearly payment of a sum certain granted to another in fee for life or years charging the person of the grantor only'; but it does not include annual instalments of a debt or purchase price of property …

52. To distinguish between an annuity and the repayment of a debt 'regard must be had to the legal rights which the transaction actually entered into confer': per Hill J in *Australia & New Zealand Savings Bank Limited v. Federal Commissioner of Taxation* (1993) 114 ALR 673; (1993) 25 ATR 369; 93 ATC 4370 at ALR 698; ATR 392; ATC 4389.

53. The terms of the OneCare Policy provide that upon the happening of a specified event ING Life has a liability of a capital lump sum to the policy owner, or the nominated beneficiary. The mere fact that the liability has to be paid out in instalments does not convert the payments into annuity payments. The 'insured amount', which is the source of the instalment payments, represents a debt owed by the insurance company to the policy owner, or to the nominated beneficiary. In *Chadwick v. Pearl Life Insurance* (1905) 2 KB 507 Walton J held that the liquidation of a principle sum by instalments was not an annuity. His Honour said at 514:

> It is obvious that there will be cases in which it will be very difficult to distinguish between an agreement to pay a debt by instalments and an agreement for good consideration to make certain annual payments for a fixed number of years. In the one case there is an agreement for good consideration to pay a fixed gross amount and to pay it by instalments. In the other there is an agreement for good consideration not to pay any fixed gross amount, but to make a certain, or it may be uncertain, number of annual payments. The distinction is a fine one and seems to depend on whether the agreement between the parties involves an obligation to pay a fixed gross sum.

54. In *Watkins,* Dwyer J held that quarterly instalments received under several policies of insurance, apart from the interest thereon, was not an annuity or assessable income and ought to be regarded in the same light as payment of an existing debt or liability. His Honour reached his conclusion on the following facts, at WALR 68-69; AITR 265; ATD 80:

> … the first is that there was a liability on the insurance company for the payment of a lump capital sum; the second is that that the change-over in payment was a payment of that capital sum with interest thereon added … the third is that the quarterly payments are expressly, by the endorsement, in lieu of payment of the one sum which would have been in cash and immediate; and a further fact for consideration is that the insured person could at any time prior to his death or before the named date in the policy and endorsement give notice in writing of his intention to cancel the condition for payment by instalment, and thereon the policy would convert to its original condition and be as if no other condition had been endorsed.

55. The factors that were present in *Watkins* are also present under the Life Cover, Trauma Cover and TPD Cover. In particular, there is a liability on ING Life to make a lump sum capital payment. The 'instalment benefit payment type' is simply the means adopted by ING Life to liquidate the obligation. The monthly payments are in lieu of payment of that capital lump sum. Lastly, under the OneCare Policy Terms, the policy owner may be able to cancel the condition for payment under the 'instalment benefit payment type' before the happening of an event.

56. These factors all lead to the conclusion that the payments under the 'instalment benefit payment type' are not an annuity and will not be assessable under section 27H of the ITAA 1936.

Payments under the 'instalment benefit payment type' not assessable as statutory income under section 15-30

57. Section 6-10 of the ITAA 1997 provides that a taxpayer's assessable income includes statutory income amounts that are not ordinary income but are included in assessable income by another provision.

58. Section 10-5 of the ITAA 1997 lists those provisions. Included in this list is section 15-30 of the ITAA 1997 which operates to include in a taxpayer's assessable income any amount received by way of insurance or indemnity for the loss of an amount if the lost amount would have been included in the taxpayer's assessable income and was not assessable under section 6-5 of the ITAA 1997.

59. The payments under the 'instalment benefit payment type' are payments received by way of insurance.

60. In *Inkster*, Lee J, after referring to paragraph 26(j) of the ITAA 1936, the predecessor to section 15-30 of the ITAA 1997 said at FCR 71-72; ATR 1533; ATC 5157-5158:

> The respondent did not suffer any loss of earnings and did not claim that he had. He no longer sought to earn income by personal exertion. For subsection 26(j) to have applied, it would have been necessary to demonstrate that an actual loss of income had been indemnified. In the respondent's case no such loss was shown and nor was it necessary. The respondent qualified for the payment of compensation when he established that he was less able to earn the ordinary wages payable to a fitter if he were to seek employment on the open market. Whatever the width of the meaning of insurance or indemnity may be, the respondent did not receive any amount for, or in respect of, any loss of income.
>
> The facts of this appeal may be distinguished from those considered by the High Court in *F.C. of T. v. Smith* where it was decided that in addition to being income within the meaning of sec. 25 of the Act, the benefits received by the taxpayer under a policy of insurance were also assessable income pursuant to subsection 26(j). In that case the payments made to the taxpayer under the policy were an indemnity against actual losses of a revenue nature suffered by the insured. The necessary characteristics were present for subsection 26(j) to apply. The Tribunal correctly decided that subsection 26(j) had no application.

61. Also, in the case of *Groves* v. *United Pacific Transport Pty. Ltd. and Thompson* (1965) Qd. R. 62, Gibbs J had to consider whether a payment received by way of insurance or indemnity was subject to tax under paragraph 26(j) of the ITAA 1936. His Honour, in taking into account the purpose of the payment held that because the compensation was paid for loss of earning capacity as distinct from loss of income which would have been assessable income if the loss had not occurred, it followed that any lump sum payment thus received was not subject to assessment under paragraph 26(j) of the ITAA 1936.

62. The payments under the 'instalment benefit payment type' are for the loss of the insured's earning capacity, and not for the loss of income. A person's earning capacity is a capital asset, therefore, any payment received to compensate for that loss is also of a capital nature and does not fall to be assessed under section 15-30 of the ITAA 1997.

'Insured amounts' under Life Cover, TPD Cover and Trauma Cover not subject to the 'accruals assessability' under Division 16E of Part III

63. Division 16E of Part III of the ITAA 1936 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.

64. However, section 159GX of the ITAA 1936 limits the application of Division 16E of Part III of the ITAA 1936 to amounts under a qualifying security that are income according to ordinary concepts and included in assessable income under another provision of the income tax law. The effect of section 159GX is to not expose to income tax amounts that would not otherwise be subject to taxation.

65. As the 'insured amount' under the Life Cover, the TPD Cover and the Trauma Cover is not assessable income under another provision of the income tax law, Division 16E of Part III of the ITAA 1936 has no application and no part of the 'insured amount' is assessable on an accruals basis.

Capital gain or loss from payments under TPD and Trauma Covers disregarded

66. A policy owner's contractual rights under a OneCare policy constitute an intangible CGT asset, (see Taxation Determination TD 93/86). CGT event C2 in section 104-25 of the ITAA 1997 happens if ownership of an intangible CGT asset ends in whole or part.

67. Each instalment benefit payment ends in part the policy owner's rights under the relevant policy. Therefore, on each occasion ING Life makes an instalment benefit payment under the TPD Cover or the Trauma Cover CGT event C2 happens. The policy owner makes a capital gain if their capital proceeds from the ending are more than the cost base of the rights. They make a capital loss if their capital proceeds from the ending are less than the reduced cost base of the rights.

68. However, a capital gain or loss made by an individual is disregarded if it relates directly to compensation or damages received by the individual for any wrong, injury or illness they or their relative suffers personally: paragraph 118-37(1)(b) of the ITAA 1997. The 'relative' of a person is defined in subsection 995-1(1) of the ITAA 1997 and includes their spouse and members of their immediate family.[2]

69. The instalment payments received by the policy owner relate to compensation or damages for a wrong, injury or illness suffered by the life insured. Therefore, the capital gain or loss resulting from the insurance payments will be disregarded for the policy owner if:

(a) the policy owner is also the life insured (because in that case the policy owner will have suffered the wrong, injury or illness personally); or

(b) the life insured is a relative of the policy owner, as that term ('relative') is defined in subsection 995-1(1) of the ITAA 1997 (because in that case the wrong, illness or injury will have been suffered personally by a relative of the policy owner).

Capital gain or loss from payments under Life Cover disregarded

70. A policy owner's contractual rights under a OneCare policy, and those rights held by a nominated beneficiary, constitute an intangible CGT asset. Each instalment benefit payment under the Life Cover ends in part the policy owner's rights under the policy, or those of the nominated beneficiary. Each such payment therefore causes CGT event C2 to happen.

71. A capital gain or loss made in relation to an interest in rights under a policy of insurance on the life of an individual is disregarded if made by the original beneficial owner of the policy or an entity that acquired the interest in the policy for no consideration: items 3 and 4 in the table in subsection 118-300(1) of the ITAA 1997. For these purposes, a policy of insurance on the life of an individual includes an insurance policy to the extent it provides for the payment of a terminal illness benefit: see Taxation Determination TD 2007/4.

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[2] Relative of a person means:
(a) the persons 'spouse'; or
(b) the parent, grandparent, brother, sister, uncle, aunt, nephew niece, lineal descendant or adopted child of that person, or of that person's spouse; or
(c) the spouse of the person referred to in paragraph (b).

72. The individual to whom the Life Cover is first issued is the original beneficial owner of the policy as that expression is used in item 3 of the table in subsection 118-300(1) of the ITAA 1997. A person nominated by the policy owner, being the nominated beneficiary, to receive the insured amount in the event of the death of the policy owner acquires, on the death of the policy owner, an interest in the policy for no consideration for the purposes of item 4 in the table in subsection 118-300(1).

73. Therefore, a capital gain or loss made by the original policy owner or a nominated beneficiary as a result of an instalment payment being made to them under the Life Cover is disregarded under subsection 118-300(1) of the ITAA 1997.

Premiums not deductible

74. The question of whether a premium is deductible depends upon whether the benefits, when paid, would be assessable. In the leading decision of *DP Smith* the High Court was unanimous on this point. In discussing the operation of subsection 51(1) of the ITAA 1936 (being the equivalent of section 8-1 of the ITAA 1997), Gibbs, Stephen, Mason, and Wilson JJ held at CLR 585; ATR 542; ATC 4117 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 connection 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 connection 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).

75. Murphy J delivered a separate judgment but concurred with the view of the majority of their Honours and stated at CLR 587; ATR 543; ATC 4118:

> 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.

76. As the payments under the 'instalment benefit payment type' are not intended to compensate for the loss of earnings but for the loss of earning capacity of the insured the premiums are not incurred in gaining or producing assessable income and, therefore, not deductible under section 8-1 of the ITAA 1997.

Appendix 2 – Detailed contents list

77. The following is a detailed contents list for this Ruling:

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

CR 2005/15; IT 155; IT 2193;
TD 93/86; TD 94/31; TD 2007/4

Subject references:

- financial products
- insurance policy
- product rulings
- public rulings
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