PR 2012/25 - Income tax: Beazley Sports Consortium 9476 - Professional Sports Person Personal Accident & Illness Insurance

Product Ruling

Income tax: Beazley Sports Consortium 9476 – Professional Sports Person Personal Accident & Illness Insurance

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, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is 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 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.

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 section apply to the defined class of entities, who take part in the scheme to which this Ruling relates. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise indicated.

2. In this Product Ruling the scheme involves the payment of insurance benefits to policy owners, or their designated beneficiaries, under the Professional Sports Person Personal Accident and Illness Insurance Policy (Policy), issued by Beazley Sports Consortium 9476 at Lloyd's (Beazley).

3. This Product Ruling does not address:

- the tax consequences of borrowing funds to pay the premium, including the deductibility of interest on funds borrowed to pay the premium;
- the tax consequences upon an assignment of a Policy; and
- the tax consequences to arise in the event the Insured refunds all monies paid in relation to a Permanent Total Disablement Benefit under a Policy in accordance with Part Five Clause 15 of the Policy Wording.

Class of entities

4. This part of the Product Ruling specifies which entities can rely on the Ruling section of this Product Ruling and which entities cannot rely on the Ruling section. In this Product Ruling, those entities that can rely on the Ruling section are referred to as the Insured and the Beneficiary.

5. The class of entities who can rely on the Ruling section of this Product Ruling consists of those entities who are individuals (not acting in a trustee capacity) and:

- are professional or semi-professional sports persons issued with a Policy (the Insured) on or after the date this Product Ruling is made and on or before 30 June 2015; or
- are designated by the Insured under the Policy issued on or after the date this Product Ruling is made and on or before 30 June 2015 as a Beneficiary entitled to receive the Death Benefit in the event of the Accidental death of the Insured.

6. The class of entities who can rely on the Ruling section of this Product Ruling does **not** include entities who:

- are issued with a Policy before the date of this Product Ruling or after 30 June 2015; or
- are designated as a Beneficiary under a Policy issued before the date of this Product Ruling or after 30 June 2015.

Superannuation Industry (Supervision) Act 1993

7. This Product Ruling does not address the provisions of the *Superannuation Industry (Supervision) Act 1993* (SISA). The Commissioner gives no assurance that the scheme is an appropriate investment for a superannuation fund. The trustees of superannuation funds are advised that no consideration has been given in this Product Ruling as to whether investment in this scheme may contravene the provisions of SISA.

Qualifications

8. The class of entities defined in this Product Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 17 to 21 of this Ruling.

9. 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

11. This Product Ruling applies prospectively from 18 July 2012, the date it is published. It therefore applies only to the specified class of entities that enter into the scheme from 18 July 2012 until 30 June 2015, being its period of application. This Product Ruling will continue to apply to those entities even after its period of application has ended for the scheme entered into during the period of application.

12. 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.

Changes in the law

13. Although this Product Ruling deals with the income tax 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 this Product Ruling and, to that extent, this Product Ruling will have no effect.

14. 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

15. 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 that promoters and advisers ensure that participants are fully informed of any legislative changes after the Product Ruling has issued.

Ruling

16. Subject to paragraph 3 and the assumptions in paragraph 21 of this Ruling:

(a) A Temporary Total Disablement Benefit received by the Insured in the event of their Temporary Total Disablement will be included in the assessable income of the Insured under section 6-5.

(b) Subject to the operation of section 118-20, any capital gain or capital loss made by the Insured in the event of their Temporary Total Disablement will be disregarded under paragraph 118-37(1)(b).

(c) A Permanent Total Disablement Benefit received by the Insured in the event of their Permanent Total Disablement will not be included in the assessable income of the Insured under section 6-5.

(d) A Permanent Total Disablement Benefit received by the Insured in the event of their Permanent Total Disablement will not be included in the assessable income of the Insured under section 15-30.

(e) A capital gain or capital loss made by the Insured in the event of their Permanent Total Disablement will be disregarded under paragraph 118-37(1)(b).

(f) A Death Benefit received by the Beneficiary in the event of the Accidental death of the Insured will not be included in the assessable income of the Beneficiary under section 6-5.

(g) A Death Benefit received by the Beneficiary in the event of the Accidental death of the Insured will not be included in the assessable income of the Beneficiary under section 15-30.

(h) A capital gain or capital loss made by the Beneficiary in the event of the Accidental death of the Insured will be disregarded pursuant to item 4 in the table in subsection 118-300(1).

(i) Premium payments incurred by the Insured will be deductible under section 8-1 to the extent that the payments relate to insurance cover for Temporary Total Disablement.

(j) Premium payments incurred by the Insured will not be deductible under section 8-1 to the extent that the payments relate to insurance cover for Permanent Total Disablement and/or Accidental death.

(k) Provided the scheme ruled on is entered into and carried out as described in this Ruling, the anti-avoidance provisions in Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936) will not apply to the Insured or the Beneficiary.

Scheme

17. The scheme that is the subject of this Ruling is identified and described in the following documents:

- application for a Product Ruling as constituted by documents and information received on 3 December 2011, 13 January 2012, 12 March 2012, 17 May 2012 and 23 May 2012; and

- Product Disclosure Statement and Policy Wording for Professional Sports Person Personal Accident & Illness Insurance.

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

18. For the purposes of describing the scheme to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which the Insured or Beneficiary, or any associate of the Insured or Beneficiary, will be a party to, which are a part of the scheme. Capitalised terms have the meaning provided in the Policy Wording.

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

Overview

20. Following is a summary of the scheme:

(a) Individual professional and semi-professional sports persons playing/competing for any kind of financial reward, referred to in this Product Ruling as the Insured, may apply to effect with Beazley (as the Insurer) a Policy.

(b) At the commencement of the Policy, the Insured is both the life insured under the Policy and the owner of the Policy. The Beneficiary is the person designated as such in the Schedule in the event of the Accidental death of the Insured.

(c) In consideration of Beazley having received a completed proposal and other relevant information that Beazley may require, as well as payment of the required premium, Beazley agrees to pay the benefits set out under the Policy to the Insured or, in the event of the Insured's Accidental death, the Insured's designated Beneficiary.

(d) The benefits payable under the Policy by Beazley are for:

(i) Temporary Total Disablement, where:

- the Insured sustains Total Disablement (that is, the complete and total physical inability to Participate in their Occupation as a result of an Accident or Illness) which begins during the Period of Insurance and continues without interruption for the Excess Period;

- the Insured is under the regular care of a Health Care Practitioner throughout the duration of the Total Disablement; and
- a Health Care Practitioner has determined that the Total Disablement is to be of continuous duration and prevents the Insured from participating in their Occupation (but has not determined that the Insured is unable to Participate ever again in their Occupation).

(ii) Permanent Total Disablement, where the Insured sustains Total Disablement within twelve months of an Accident or Illness which then results in the Permanent Total Disablement of the Insured (that is, Total Disablement for the entire duration of the Elimination Period and a Health Care Practitioner determines that the Insured is unable to Participate ever again in their Occupation); and

(iii) Accidental death, where the Insured dies as a result of, and within twelve months of, an Accident.

(e) The amount of insurance cover that relates to each of the three specific benefit components is agreed between the Insured and Beazley. The benefit amount(s) payable under each component does not include investment income or an accruals component from the investment of the premium.

(f) The Policy is not a ‘life policy’ as defined in the *Life Insurance Act 1995* or an ‘annuity instrument’ as defined in section 995-1 of the ITAA 1997.

(g) The Policy does not have a surrender value.

(h) Subject to Beazley’s assessment and approval, the Policy may be continued each year upon payment of premiums. Insured persons may be introduced to an external source of finance from a party unrelated to Beazley to fund their annual premium on commercial terms. This Ruling does not consider the tax consequences associated with such a borrowing.

Assumptions

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

(a) the Insured and the Beneficiary are Australian residents for taxation purposes;

(b) a Temporary Total Disablement Benefit is received periodically by the Insured;

(c) a Permanent Total Disablement Benefit is typically received in a lump sum by the Insured, but may be received periodically;

(d) a Death Benefit is received in a lump sum by the Beneficiary;

(e) all dealings between the Insured, Beneficiary and Beazley will be at arm's length; and

(f) the scheme will be executed in the manner described in the Scheme section of this Ruling and the scheme documentation referred to in paragraph 17 of this Ruling.

Commissioner of Taxation
18 July 2012

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.

Temporary Total Disablement Benefit assessable as ordinary income under section 6-5

22. Section 6-5 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.

23. The characterisation to be accorded to the insurance proceeds payable to the Insured in respect of their Temporary Total Disablement 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 Temporary Total Disablement cover, the Insured takes out a Policy with the intention to receive the insured amount on the happening of a specified event, being their Total Disablement which prevents them from Participating in their Occupation for a continuous but finite period. The Temporary Total Disablement Benefit payable in the event of the Insured's Temporary Total Disablement is intended to compensate the Insured for the loss of earnings.

24. Ordinarily, the receipt of insurance proceeds to replace lost earnings would be ordinary income: *Federal Commissioner of Taxation v. DP Smith* (1981) 147 CLR 578; 11 ATR 538; 81 ATC 4114 (*DP Smith*). This is to be distinguished from circumstances under which the receipt of insurance proceeds is intended to compensate for the loss of earning capacity.

25. Accordingly, the payments under the Temporary Total Disablement cover are ordinary income (and not capital receipts), assessable under section 6-5.

Permanent Total Disablement Benefit and Death Benefit not assessable as ordinary income under section 6-5

26. As is the case in respect of the Insured's Temporary Total Disablement, the characterisation to be accorded to the insurance proceeds payable to the Insured in respect of their Permanent Total Disablement and Accidental death will depend on the purpose of the payments and the circumstances of their receipt. Under the Permanent Total Disablement cover, the Insured takes out a Policy with the intention to receive the insured amount on the happening of a specified event, being their Total Disablement which prevents them from Participating in their Occupation ever again. Under the Accidental death cover, the Insured takes out a Policy with the intention for the Beneficiary to receive the insured amount on the

happening of the death of the Insured from an Accident. The Permanent Total Disablement Benefit and Death Benefit payable in the event of the Insured's Permanent Total Disablement and Accidental death, respectively, is intended not to compensate the Insured or their designated Beneficiary for the loss of earnings but for the loss of earning capacity of the Insured.

27. 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: *Federal Commissioner of Taxation v. Slaven* (1984) 1 FCR 11; 15 ATR 242; 84 ATC 4077. Such payments are capital in nature.

28. Whether the receipt of a Permanent Total Disablement Benefit in regular or periodic instalments (rather than in a lump sum) alters the character of the receipt 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.

29. In accordance with the principle enunciated in *Dixon*, an amount paid in substitution for another amount takes the character of the substituted amount. Therefore, any Permanent Total Disablement Benefit paid periodically in substitution for a capital payment retains its capital characterisation.

30. Further, compensation for loss of earning capacity does not lose its character as a capital receipt simply because the amount of compensation is calculated by reference to the amount of income the Insured would have earned had they not sustained a Permanent Total Disablement or died as a result of an Accident.

31. Accordingly, the Permanent Total Disablement Benefit and Death Benefit are capital receipts, and are not assessable under section 6-5 as ordinary income.

Permanent Total Disablement Benefit and Death Benefit not assessable as statutory income under section 15-30

32. Section 6-10 includes statutory income in assessable income (that is, amounts that are not ordinary income but are included in assessable income by another provision). Section 15-30 is one such provision which operates to include in your assessable income an amount received by way of insurance or indemnity for the loss of an amount if the lost amount would have been included in your assessable income and the amount received is not assessable as ordinary income under section 6-5.

33. Both the Permanent Total Disablement Benefit and Death Benefit are payments received by way of insurance.

34. Whether a payment received by way of insurance or indemnity is subject to tax under paragraph 26(j) of the ITAA 1936 (the predecessor to section 15-30 of the ITAA 1997) was considered in *Federal Commission of Taxation v. Inkster* (1989) 89 ALR 137; (1989) 20 ATR 1516; 89 ATC 5142 and *Groves* v. *United Pacific Transport Pty. Ltd. and Thompson* (1965) Qd. R. 62. As the compensation paid under these cases was for the loss of earning capacity, as distinct from the loss of income which would have been assessable income if the loss had not occurred, it was held that any payment thus received was not subject to assessment under paragraph 26(j) of the ITAA 1936. For subsection 26(j) of the ITAA 1936 to have applied, it would have been necessary to demonstrate that an actual loss of income suffered by the insured had been indemnified.

35. The Permanent Total Disablement Benefit and Death Benefit 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 the loss of that capital asset is a capital receipt and does not fall to be assessed under section 15-30.

Capital gain or loss from payments under the Policy disregarded

36. Under subsection 108-5(1) a CGT asset is any kind of property or a legal or equitable right that is not property. The contractual rights of the Insured and Beneficiary under the Policy are legally enforceable rights and therefore a CGT asset according to the definition in subsection 108-5(1).

37. Where Beazley makes a payment of the Temporary Total Disablement Benefit, Permanent Total Disablement Benefit or Death Benefit in satisfaction of the Insured's or Beneficiary's contractual rights under the Policy, their ownership of those rights are discharged or satisfied in whole or part. This discharge or satisfaction of the contractual rights gives rise to CGT event C2 (paragraph 104-25(1)(b)).

38. The Insured, or the Beneficiary in the event of the Insured's Accidental death, 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, alternatively, a capital loss if those capital proceeds are less than the asset's reduced cost base (subsection 104-25(3)).

Section 118-37 - Temporary Total Disablement Benefit and Permanent Total Disablement Benefit

39. Section 118-37 disregards a capital gain or capital loss relating to compensation or damages received by a taxpayer as a result of any wrong, injury or illness they or their relative suffered.

40. A receipt of an amount under an insurance policy for a non-death benefit such as Temporary Total Disablement or Permanent Total Disablement constitutes a form of compensation or damages covered by paragraph 118-37(1)(b) where the amount is received for a wrong, injury or illness suffered personally by the recipient or the recipient's relative.

41. Any capital gain or capital loss the Insured makes under section 104-25 upon payment of a Temporary Total Disablement Benefit (to the extent that any such capital gain has not already been reduced pursuant to the operation of section 118-20) or Permanent Total Disablement Benefit by Beazley under the Policy in respect of the Temporary or Permanent Total Disablement suffered by the Insured will be disregarded under paragraph 118-37(1)(b).

Section 118-300 - Death Benefit

42. Section 118-300 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) 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).[1]

43. Item 4 of the table in subsection 118-300(1) provides that a capital gain or capital loss you made from a CGT event happening in relation to a CGT asset that is an interest in rights under a general insurance policy is disregarded where that CGT event happens to an entity that acquired the interest in the policy for no consideration.

44. A designated Beneficiary would be taken to have acquired rights under the Policy for no consideration. The Beneficiary will therefore be entitled under item 4 in the table in subsection 118-300(1) to disregard any capital gain or capital loss they make under section 104-25 from the receipt of a payment of a Death Benefit from Beazley.

[1] *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?*

Premiums relating to Temporary Total Disablement deductible

45. Generally, 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 subsection 51(1) of the ITAA 1936 (being the equivalent of section 8-1 of the ITAA 1997) in the High Court decision of *DP Smith*, 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).

46. 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.

47. As the Temporary Total Disablement Benefit is intended to compensate for the loss of earnings of the Insured and would be assessable to the Insured (see paragraphs 22 to 25 of this Product Ruling), the premiums that relate to Temporary Total Disablement cover are incurred in gaining or producing assessable income and therefore deductible under section 8-1.

Premiums relating to Permanent Total Disablement and Accidental death not deductible

48. As the Permanent Total Disablement Benefit and Death Benefit are not intended to compensate for the loss of earnings of the Insured but are intended to compensate for the loss of earning capacity of the Insured they are treated as capital (see paragraphs 26 to 31 of this Product Ruling). The premiums are not incurred in gaining or producing assessable income to the extent that they relate to Permanent Total Disablement and Accidental death cover, and therefore are not deductible under section 8-1. Premiums that are not deductible under section 8-1 are included in the first element of the cost base or reduced cost base of the CGT asset referred to in paragraph 36 of this Product Ruling (subsections 110-25(2) and 110-55(2)).

Part IVA – anti-avoidance

49. Provided that the scheme ruled on is entered into and carried out as disclosed in this Ruling, it is accepted that the scheme is an ordinary commercial transaction and Part IVA of the ITAA 1936 will not apply.

Appendix 2 – Detailed contents list

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

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TD 2007/4

Subject references:

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

Legislative references:

- ITAA 1936 26(j)
- ITAA 1936 51(1)
- ITAA 1997 Pt IVA
- ITAA 1997
- ITAA 1997 6-5
- ITAA 1997 6-10
- ITAA 1997 8-1
- ITAA 1997 15-30
- ITAA 1997 104-25
- ITAA 1997 104-25(1)(b)
- ITAA 1997 104-25(3)
- ITAA 1997 108-5(1)
- ITAA 1997 110-25(2)
- ITAA 1997 110-55(2)
- ITAA 1997 118-20
- ITAA 1997 118-37
- ITAA 1997 118-37(1)(b)
- ITAA 1997 118-300
- ITAA 1997 118-300(1)
- ITAA 1997 995-1
- ITAA 1997 995-1(1)
- Life Insurance Act 1995
- SISA 1993
- TAA 1953
- Copyright Act 1968

Case references:

- FC of T v. Inkster (1989) 89 ALR 137; (1989) 20 ATR 1516; 89 ATC 5142
- FC of T v. Dixon (1952) 86 CLR 540; (1952) 10 ATD 82; (1952) 5 AITR 443
- FC of T v. DP Smith (1981) 147 CLR 578; (1981) 11 ATR 538; 81 ATC 4114
- FC of T v. Slaven (1984) 1 FCR 11; (1984) 15 ATR 242; 84 ATC 4077
- Groves v. United Pacific Transport Pty. Ltd. and Thompson (1965) Qd. R. 62
- Tinkler v. FC of T (1979) 29 ALR 663; (1979) 10 ATR 411; 79 ATC 4641

ATO references

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