

# ***PR 2012/28 - Income tax: tax consequences for Holders of CashPlus Base fixed term annuities***

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## Product Ruling

### Income tax: tax consequences for Holders of CashPlus Base fixed term annuities

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#### **📌 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**

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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.

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 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 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**

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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

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1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provisions identified in the Ruling part apply to the defined class of entities who participate in the scheme to which this Product 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 is an investment in a CashPlus Base fixed term annuity (CashPlus Base) offered by Challenger Life under separate Offer Documents.
3. This Product Ruling does not address:
  - the taxation consequences of acquiring, holding and disposing or redeeming a CashPlus Base, other than as per paragraphs 17 to 30 of this Product Ruling;
  - the taxation consequences for holders (Holders) of a CashPlus Base that effect a commutation of the CashPlus Base policy;
  - the taxation consequences of acquiring, holding and disposing or redeeming a CashPlus Base where it has been acquired by a Holder that is a superannuation entity with assets of less than \$100 million;
  - the taxation consequences of making an election under Subdivision 230-C, Subdivision 230-D, Subdivision 230-E and Subdivision 230-F of the ITAA 1997; and
  - the taxation consequences of borrowing funds to acquire a CashPlus Base, including the deductibility of interest on funds borrowed to acquire a CashPlus Base.

### 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 a Holder.
5. The class of entities who can rely on the Ruling section of this Product Ruling consists of those Holders that are accepted to participate in the scheme described in paragraphs 17 to 30 of this Product Ruling on or after the date this Product Ruling is published and on or before 30 June 2014. They must have an intention of staying in the scheme until it is completed (that is, holding on to their investment until maturity).

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

- intend to terminate their involvement in the scheme prior to its completion; or
- are accepted to participate in the scheme described in paragraphs 17 to 30 of this Product Ruling before the date of this Product Ruling or after 30 June 2014.

### ***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 30 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.

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## Date of effect

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11. This Product Ruling applies prospectively from 22 August 2012, the date it is published. It therefore applies to the specified class of entities that enter into the scheme from 22 August 2012 to 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 the 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

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### Application of this ruling

16. Subject to paragraph 3 of this Ruling and the assumptions in paragraph 30 of this Ruling:

- (a) A CashPlus Base is a qualifying security as defined under subsection 159GP(1) *Income Tax Assessment Act 1936* (ITAA 1936);
- (b) Holders will be subject to Division 230 in respect of their CashPlus Base;
- (c) For the purposes of subsection 230-105(1), Holders will have a 'sufficiently certain overall gain' in respect of their CashPlus Base;

- (d) For the purposes of subsection 230-130(1), Holders will bring to account their gains and losses in respect of their CashPlus Base over the period between the date on which they are acquired and the Maturity Date;
- (e) A CashPlus Base is capable of being held by Holders who are trustees of a complying superannuation fund paying an account-based pension as part of the fund's segregated current pension assets for the purposes of section 295-385;
- (f) 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 ITAA 1936 will not apply to Holders.

## Scheme

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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 correspondence received on 11 May 2012;
- Policy Document; and
- Investor Certificate.

**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. The documents highlighted in paragraph 17 of this Ruling are those that an Investor will enter into. 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 an Investor or any associate of an Investor, will be a party to, which are a part of the scheme.

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

### Overview

20. The CashPlus Base is a fixed term annuity issued by Challenger Life to the Holder.

21. The CashPlus Base is only offered by Challenger Life in Australia to superannuation entities that are complying superannuation funds for the purposes of the ITAA 1997.

22. To purchase a CashPlus Base, Holders must execute the Application Form and pay the Premium to Challenger Life. No additional fees or charges are payable to Challenger Life by the Holders.
23. Upon acceptance of a valid application, the Holder will be issued with the Investor Certificate and Policy Document.
24. The Policy Document is a legal contract between the Holder and Challenger Life Company Limited and is non-transferable under clause 10 of the policy.
25. The minimum subscription amount is AUD 50 Million.
26. The Holder agrees to pay a purchase price, as agreed between Challenger Life and the Holder in exchange for an agreed series of periodic income streams exceeding the face value over the term of the policy. The term of each policy will be 730 days.
27. Challenger Life will pay the Holder a first payment, followed by four income payments at quarterly intervals from the date of issue, and a nominal final payment (equal to the residual capital value of the CashPlus Base policy) on maturity date. The total of the six payments will exceed the face value of the policy. The payments will be made on the dates outlined in the payment schedule in the Investor Certificate.
28. No fee is payable by the Holder on an application for a CashPlus Base Policy.
29. The Holder may effect a commutation of the CashPlus Base. Challenger Life will ascertain a commutation value (calculated in accordance with the minimum surrender value specified in the prudential standards issued pursuant to the *Life Insurance Act 1995* and other relevant laws) and pay this amount to the Holder.

## Assumptions

30. This Ruling is made on the basis of the following assumptions:
  - a) All Holders are Australian complying superannuation funds for the purposes of the ITAA 1997;
  - b) A Holder that is a complying superannuation fund has assets of more than AUD 100 Million;
  - c) The CashPlus Base policy is an annuity that at all relevant times is subject to a declaration under section 12A of the *Life Insurance Act 1995* that is, it is life insurance business, and hence satisfies the definition of a life insurance policy under subsection 995-1(1).
  - d) Holders of a CashPlus Base have not made a valid tax-timing election under Division 230.

- e) Holders that are complying superannuation funds are not prevented from making such an investment by any particular terms of the fund's trust deed, and are not in breach of any stated investment strategy of the fund;
- f) The scheme will be executed in the manner described in the Scheme section of this Ruling; and
- g) All dealings between the Holders and Challenger Life will be at arm's length.

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**Commissioner of Taxation**

22 August 2012

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## Appendix 1 – Explanation

❶ ***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.***

### **Division 16E qualifying security**

31. CashPlus Base is an annuity for the purposes of the *Life Insurance Act 1995*.
32. Section 27H(1)(a) of the ITAA 1936 states that the assessable income of a taxpayer shall include:

The amount of any annuity derived by the taxpayer during the year of income excluding, in the case of an annuity that has been purchased, any amount that, in accordance with the succeeding provisions of this section, is the deductible amount in relation to the annuity in relation to the year of income.
33. Section 27H(4) of the ITAA 1936 defines 'annuity' as:

An annuity, a pension paid from a foreign superannuation fund or a pension paid from a scheme in paragraph 290-5(c) of the ITAA 1997, but does not include...

  - b) An annuity that is a qualifying security for the purposes of Division 16E
34. It is therefore necessary to consider whether the CashPlus Base is a qualifying security for the purposes of Division 16E of the ITAA 1936.
35. Securities which are qualifying securities as defined in subsection 159GP(1) of the ITAA 1936 will be subject to the accruals provisions of Division 16E. A qualifying security must, among other requirements, have an eligible return. Subsection 159GP(3) defines an eligible return in relation to a security as follows:

For the purposes of this Division, there shall be taken to be an eligible return in relation to a security if at the time when the security was issued it is reasonably likely, by reason that the security was issued at a discount, bears deferred interest or is capital indexed or for any other reason, having regard to the terms of the security, for the sum of all payments (other than periodic interest payments) under the security to exceed the issue price of the security, and the amount of the eligible return is the amount of the excess.
36. Thus, if the return (other than of the issue price) to Holders of a CashPlus Base consists only of periodic interest payments, the CashPlus Base annuity will not have an eligible return and will not be a qualifying security for the purposes of Division 16E.
37. There are no amounts of periodic interest paid under CashPlus Base.
38. The Income Payments will thus form an eligible return in relation to the CashPlus Base for the purposes of subsection 159GP(3).

39. As required by the definition of a qualifying security in subsection 159GR(1), the precise amount of the eligible return is able to be ascertained at the time of issue of the security and is greater than 1.5% of the amount ascertained by multiplying the amount of the payment or the sum of the payments (excluding any periodic interest) liable to be made under the security by the number (including any fraction) of years in the term of the security.

40. The CashPlus Base will not be a qualifying security where the security is an ineligible annuity.

41. Under section 159GP(1) an 'ineligible' annuity means an annuity 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. The CashPlus Base is issued by Challenger Life to the Holder who is a trustee of an Australian complying superannuation fund; the Holder is not a natural person.

42. The CashPlus Base will therefore constitute a qualifying security as defined under subsection 159GP(1).

#### **Division 230 – taxation of financial arrangements (TOFA)**

43. Division 230 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 right and/or obligations (subsection 230-45(1)). A right to receive or obligation to provide a financial benefit can be cash 'settlable' under subsection 230-45(2) 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.

44. The CashPlus Base constitutes a financial arrangement for the purposes of Division 230 on the basis that Holders have cash settlable rights to receive a financial benefit in the form of quarterly Income Payments over the term of the CashPlus Base, and a cash settlable obligation to provide a financial benefit in the form of the Premium to Challenger Life.

45. As a consequence, Division 230 applies in relation to gains or losses from CashPlus Base annuities held by Holders. The exceptions to the application of Division 230 in subsection 230-5(2), section 230-455 and subsection 230-460(5) do not apply.

46. Where an overall gain or loss from a financial arrangement is sufficiently certain at the time when the arrangement starts, the accruals method under Subdivision 230-B applies to the gain or loss (subsection 230-100(2)).

47. A sufficiently certain overall gain or loss from a financial arrangement at the time the arrangement starts is one that is of a particular amount or at least a particular amount, with regard only to financial benefits that are sufficiently certain to be received and provided to the extent that at least some of the amount or value of the benefit is, at that time, fixed or determinable with reasonable accuracy (sections 230-105 and 230-115).

48. For the purposes of determining whether a Holder will make an overall gain or loss in respect of the CashPlus Base annuity, Holders will need to take into account their obligation to pay the Premium to Challenger Life and their right to receive quarterly Income Payments from Challenger Life. Having regard to the terms of the CashPlus Base:

- the Premium to be paid by the Holders to Challenger Life will be for an amount that, at the time of acquisition of the CashPlus Base annuities, is fixed or determinable with reasonable accuracy, and therefore a financial benefit that Holders are sufficiently certain to provide; and
- the amount of the Income Payments Challenger Life is obligated to make to the Holders over the term of the CashPlus Base will be determinable with reasonable accuracy, and therefore a financial benefit that Holders are sufficiently certain to receive.

49. As the Income Payments to be received by Holders will comprise an aggregate of Income Payments in excess of 100% of their Premium, it is sufficiently certain for the purposes of subsection 230-105(1) that at the time of acquisition Holders will make an overall gain from their CashPlus Base to which the accruals method will apply.

50. Where, under the accruals method, a Holder has a sufficiently certain overall gain from a CashPlus Base under subsection 230-105(1), the period over which the gain is to be spread in accordance with subsection 230-130(1) is the period of the arrangement, being the period that starts when the Holder starts to have the CashPlus Base annuity (that is, the date that the Premium is accepted by Challenger Life as specified in the Investor Certificate) and ends when the Holder ceases to have the CashPlus Base, assuming the Holder will continue to hold the CashPlus Base until maturity (that is, the Policy maturity date on which the final Income Payment is to be made).

51. Under section 230-20(4)(a), a gain or loss to which this section applies is not to be (to any extent) included in your assessable income again under any provision of the ITAA 1936 or ITAA 1997 outside this Division for the same or any other income year.

52. Thus, an Investor holding a CashPlus Base policy will be taxed under the TOFA provisions and not Division 16E.

**Can CashPlus Base annuities be held by complying superannuation funds as segregated current pension assets?**

53. A complying superannuation fund is entitled to an exemption for so much of its income as is attributable to its liability to pay current pensions. More specifically and pursuant to section 295-385, a complying superannuation fund is entitled to an exemption from income tax for so much of its ordinary income or statutory income (other than assessable contributions or non-arm's length income of the fund) to the extent that it is derived from the fund's segregated current pension assets, the meaning of which is set out in subsections 295-385(3), (4), (5) and (6).

54. Under this method of determining the exempt amount, the complying superannuation fund segregates its assets as specifically relating to its current pension liabilities to pay 'superannuation income stream benefits' as certified in an actuary's certificate or as prescribed by regulations. The prescribed superannuation income stream benefits include account-based pensions within the meaning of the Superannuation Industry (Superannuation) Regulations 1994 (SISR) (regulation 295-385.01 of the Income Tax Assessment Regulations 1997 (ITAR 1997)).

55. Subject to regulation 995-1.03 of the ITAR 1997, a superannuation income stream benefit is defined under regulation 995-1.01 of the ITAR 1997 to mean a payment from an interest that supports a 'superannuation income stream'. A superannuation income stream itself is defined under regulation 995-1.01 of the ITAR 1997 to include an income stream that is taken to be a pension for the purposes of the SISA in accordance with subregulation 1.06(1) of the SISR.

56. An account-based pension is a pension that meets the requirements in subregulation 1.06(1) of the SISR and in accordance with subregulation 1.03(1) of the SISR, is a pension that is provided in accordance with the rules of a fund that both meet the standards of subregulation 1.06(9A) of the SISR and are described in paragraph 1.06(9A)(a) of the SISR.

57. CostPlus Base annuities are assets of a type to which, for the purposes of paragraph 1.06(9A)(a) of the SISR, an account balance may be attributed. These annuities are therefore capable of being held by Holders who are trustees of complying superannuation funds as segregated current pension assets to support the payment of account-based pensions. Ultimately, whether any particular complying superannuation fund does hold the CostPlus Base annuities as part of its segregated current pension assets for the purposes of section 295-385 will depend on each fund's particular facts and circumstances.

## **Part IVA – anti-avoidance**

58. 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**

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

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## References

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*Previous draft:*

Not previously issued as a draft

*Subject References:*

- exempt income
- income tax
- producing assessable Income
- product rulings
- public rulings
- qualifying securities
- securities
- segregated current pension assets
- superannuation
- taxation administration
- taxation of financial arrangements

- ITAA 1997 230-45(1)
- ITAA 1997 230-45(2)
- ITAA 1997 230-100(2)
- ITAA 1997 230-105
- ITAA 1997 230-105(1)
- ITAA 1997 230-115
- ITAA 1997 230-115(4)
- ITAA 1997 230-115(5)
- ITAA 1997 230-115(6)
- ITAA 1997 230-130(1)
- ITAA 1997 230-175(1)
- ITAA 1997 230-175(2)
- ITAA 1997 Subdiv 230-G
- ITAA 1997 230-455
- ITAA 1997 230-460(5)
- ITAA 1997 295-385
- ITAA 1997 295-385(3)
- ITAA 1997 295-385(4)
- ITAA 1997 295-385(5)
- ITAA 1997 295-385(6)
- ITAR 1997 295-385.01
- ITAR 1997 995-1.01
- ITAR 1997 995-1.03
- SISA 1993
- SISR 1994 1.03(1)
- SISR 1994 1.06(1)
- SISR 1994 1.06(9A)
- SISR 1994 1.06(9A)(a)
- TAA 1953
- Copyright Act 1968
- Life Insurance Act 1995
- Public Authorities (Financial – Arrangements) Act 1987

*Legislative References:*

- ITAA 1936 27H(1)
- ITAA 1936 27H(4)
- ITAA 1936 Div 16E
- ITAA 1936 159GP(1)
- ITAA 1936 159GP(3)
- ITAA 1936 159GP(6)
- ITAA 1936 159GP(7)
- ITAA 1936 Pt IVA
- ITAA 1997
- ITAA 1997 Div 230
- ITAA 1997 230-45(1)
- ITAA 1997 230-45(2)
- ITAA 1997 Subdiv 230-B
- ITAA 1997 230-5(2)

## ATO references

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