

PR 2013/1 - Income tax: MLC Limited - MLC Insurance - Income Protection Platinum Cover

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Product Ruling

Income tax: MLC Limited – MLC Insurance – Income Protection Platinum Cover

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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

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 provisions 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 under MLC Insurance (the Policy) issued by MLC Limited (MLC) in respect of the Income Protection Platinum cover.
3. This Product Ruling does not:
 - address the tax consequences to arise in respect of any cover offered under the Policy other than the Income Protection Platinum cover;
 - address the tax consequences to arise upon payment of a Death Benefit under the Income Protection Platinum cover;
 - address the tax consequences to arise in respect of the acquisition of MLC Insurance (Super);
 - address the tax consequences upon the transfer of the ownership of the Policy to another entity; or
 - apply to any benefits and options available at extra cost under the Policy, including the:
 - Nursing Care Benefit;
 - Accommodation Benefit;
 - Transportation Benefit;
 - Home Assistance Benefit; and
 - Critical Illness Benefit.

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 Policy Owner.
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) issued with the Policy (the Policy Owner) on or after 1 July 2012 and on or before 30 June 2015.

6. The class of entities who can rely on the Ruling section of this Product Ruling does **not** include entities who are issued with the Policy before 1 July 2012 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.

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Barton ACT 2600

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Date of effect

11. This Product Ruling applies prospectively from 1 July 2012. It therefore applies only to the specified class of entities that enter into the scheme from 1 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) Monthly Benefits received by a Policy Owner under the Income Protection Platinum cover will be included in the assessable income of the Policy Owner under section 6-5.
- (b) A lump sum benefit received by a Policy Owner under the Lump Sum Benefit Option will not be included in the assessable income of the Policy Owner under section 6-5.
- (c) A capital gain or capital loss made by a Policy Owner upon receipt of a lump sum benefit under the Lump Sum Benefit Option will be disregarded under paragraph 118-37(1)(b).
- (d) Premiums incurred by a Policy Owner in respect of the Income Protection Platinum cover will be deductible under section 8-1 to the extent that they do not relate to the Lump Sum Benefit Option.

- (e) Premiums incurred by a Policy Owner in respect of the Income Protection Platinum cover will not be deductible under section 8-1 to the extent that they relate to the Lump Sum Benefit Option. Pursuant to the assumption at paragraph 21(d) of this Product Ruling, the portion of the premiums which relate to the Lump Sum Benefit Option is 10 per cent.
- (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 *Income Tax Assessment Act 1936* (ITAA 1936) will not apply to a Policy Owner.

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 12 July 2012, 20 August 2012, 10 September 2012, 26 October 2012 and 6 December 2012;
- MLC Insurance MLC Insurance (Super) Product Disclosure Statement dated 5 March 2012; and
- MLC Insurance Policy Document dated 5 March 2012.

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 Policy Owner, or any associate of the Policy Owner, will be a party to, which are a part of the scheme. Capitalised terms have the meaning provided in the Product Disclosure Statement and/or the Policy Document.

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) As part of its insurance business, MLC issues the Policy in accordance with the Product Disclosure Statement and Policy Document referred to in paragraph 17 of this Product Ruling offering, amongst other types of cover, the Income Protection Platinum cover which is offered to individuals only.
 - (b) Any Benefit payable under the Policy will be paid by MLC upon MLC's satisfaction that all events entitling payment of the Benefit has happened. In the case of the Income Protection Platinum cover, MLC is required to pay a Monthly Benefit to the Policy Owner for each month the Life Insured is either Totally Disabled or Partially Disabled, up to the maximum Benefit Period, as chosen by the Policy Owner. The Life Insured under the Income Protection Platinum cover is generally the Policy Owner.
 - (c) The Monthly Benefits payable by MLC under the Income Protection Platinum cover is an amount agreed between the Policy Owner and MLC, subject to a particular maximum Monthly Benefit payable as determined on the basis of the Life Insured's Earnings, and increased annually by the CPI. The Monthly Benefit does not include investment income or an accruals component from the investment of the premium.
 - (d) At the time of acquiring the Income Protection Platinum cover, and where the Life Insured belongs in one of the listed occupation groups, a Policy Owner may select the Lump Sum Benefit Option at no additional cost to the premium payable by the Policy Owner to MLC for the Income Protection Platinum cover. Selection of the Lump Sum Benefit Option enables the Policy Owner to receive a lump sum benefit from MLC rather than the Monthly Benefits otherwise payable under the Income Protection Platinum cover. The amount of the lump sum benefit is set out in the Product Disclosure Statement and Policy Document.
 - (e) A Policy Owner who has selected the Lump Sum Benefit Option is not obliged to exercise the Option. The Lump Sum Benefit Option can only be exercised by a Policy Owner upon their written request at the time of making a claim and if:
 - the Policy Owner has satisfied the Qualification Period; and

- the Life Insured has not been diagnosed as terminally ill and likely to die within 12 months from the date the Qualification Period is satisfied.
- (f) Satisfaction of the Qualification Period requires the Policy Owner to have received Total Disability Benefit payments for 24 continuous months solely as a result of the Sickness or Injury which caused or is related to the Life Insured's Total and Permanent Disability.
- (g) The Lump Sum Benefit Option, once selected, cannot be cancelled and, unless exercised, will end when the Life Insured turns 65.
- (h) When the Lump Sum Benefit Option is exercised and the lump sum benefit is paid, the Policy Owner's Income Protection Platinum cover ends and no further benefits of any kind are payable under this cover.
- (i) The Policy can be continued each year upon the payment of premiums by the Policy Owner to MLC in full.
- (j) The Policy does not have a surrender value.

Assumptions

21. This Ruling is made on the basis of the following assumptions:
- (a) the Policy Owner is an Australian resident for taxation purposes;
 - (b) the Policy Owner is also the Life Insured;
 - (c) the Lump Sum Benefit Option is a rider to the Income Protection Platinum cover which provides the Policy Owner with separate and additional contractual rights;
 - (d) the method of apportionment of the premium applied by MLC in the Actuarial report dated 16 March 2012 is fair and reasonable in the circumstances;
 - (e) all dealings between the Policy Owner and MLC 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.

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.***

Monthly Benefits 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 Monthly Benefits payable to the Policy Owner 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 Income Protection Platinum cover, the Policy Owner takes out the Policy with the intention to receive the Monthly Benefits on the happening of a specified event, being their Total or Partial Disability which prevents them from performing the duties of their occupation necessary to produce some or all of their Earnings. The Monthly Benefits payable under the Income Protection Platinum cover are intended to compensate the Policy Owner 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 of the Monthly Benefits under the Income Protection Platinum cover are ordinary income (and not capital receipts), assessable under section 6-5.

Lump sum benefit not assessable as ordinary income under section 6-5

26. As is the case in respect of the Monthly Benefits, the characterisation to be accorded to the lump sum benefit payable to a Policy Owner under the Lump Sum Benefit Option will depend on the purpose of the payment and the circumstances of its receipt. Under the Income Protection Platinum cover, the Policy Owner selects the Lump Sum Benefit Option with the intention of receiving the lump sum benefit on the happening of a specified event, being their Total and Permanent Disability which is likely to prevent them from performing the duties of their occupation ever again. The lump sum benefit payable under the Lump Sum Benefit Option is intended not to compensate the Policy Owner for the loss of earnings but for the loss of their earning capacity.

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. Accordingly, the lump sum benefit under the Lump Sum Benefit Option is a capital receipt, and is not assessable under section 6-5 as ordinary income.

Capital gain or loss from payment under the Lump Sum Benefit Option disregarded

29. 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 a Policy Owner under the Lump Sum Benefit Option are legally enforceable rights and therefore a CGT asset according to the definition in subsection 108-5(1).

30. Where MLC makes a payment of the lump sum benefit in satisfaction of the Policy Owner's contractual rights under the Lump Sum Benefit Option, 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)).

31. The Policy Owner 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)).

32. 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.

33. A receipt of an amount under an insurance policy for a non-death benefit such as total and permanent 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.

34. Any capital gain or capital loss the Policy Owner makes under section 104-25 upon payment of the lump sum benefit by MLC under the Lump Sum Benefit Option in respect of the Total and Permanent Disability suffered by the Policy Owner will be disregarded under paragraph 118-37(1)(b).

Deductibility of premiums

35. 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).

36. 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.

37. As the Monthly Benefits are intended to compensate for the loss of earnings of the Policy Owner and would be assessable to the Policy Owner (see paragraphs 22 to 25 of this Product Ruling), the premiums incurred by a Policy Owner under the Income Protection Platinum cover, excluding the portion of the premiums that relate to the Lump Sum Benefit Option, are incurred in gaining or producing assessable income and therefore deductible under section 8-1.

38. As the lump sum benefit is not intended to compensate for the loss of earnings of the Policy Owner but is intended to compensate for the loss of earning capacity of the Policy Owner it is treated as capital (see paragraphs 26 to 28 of this Product Ruling). The premiums are not incurred in gaining or producing assessable income to the extent that they relate to the Lump Sum Benefit Option, 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 29 of this Product Ruling (subsections 110-25(2) and 110-55(2)).

39. Section 8-1 does not prescribe any method of apportioning expenditure. The portion of the premiums incurred by a Policy Owner under the Income Protection Platinum cover which is not deductible under section 8-1, as per paragraph 38 of this Product Ruling, should be determined pursuant to a method of apportionment that is both fair and reasonable in the circumstances. Pursuant to the assumption at paragraph 21(d) of this Product Ruling, the portion of the premiums which relate to the Lump Sum Benefit Option, and is therefore not deductible under section 8-1, is 10 per cent.

Part IVA – anti-avoidance

40. 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

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

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References

Previous draft:

Not previously issued as a draft

Subject references:

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

Legislative references:

- ITAA 1936 51(1)
- ITAA 1936 Pt IVA
- ITAA 1997
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 104-25
- ITAA 1997 104-25(1)(b)

- ITAA 1997 104-25(3)
- ITAA 1997 108-5(1)
- ITAA 1997 118-37
- ITAA 1997 118-37(1)(b)
- SISA 1993
- TAA 1953
- Copyright Act 1968

Case references:

- 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
- Tinkler v. FC of T (1979) 29 ALR 663; (1979) 10 ATR 411; 79 ATC 4641

ATO references

NO: 1-46E36MJ

ISSN: 1441-1172

ATOLaw topic: Income Tax ~~ Product ~~ finance