


***PR 2013/5 - Income tax: OnePath Life Limited -
OneCare Policy - Life Cover, Total and Permanent
Disability Cover and/or Trauma Cover - Value
Protector Option***

 This cover sheet is provided for information only. It does not form part of *PR 2013/5 - Income tax: OnePath Life Limited - OneCare Policy - Life Cover, Total and Permanent Disability Cover and/or Trauma Cover - Value Protector Option*



Product Ruling

Income tax: OnePath Life Limited – OneCare Policy – Life Cover, Total and Permanent Disability Cover and/or Trauma Cover – Value Protector Option

| Contents | Para |
|----------|------|
|----------|------|

| | |
|-------------------------------------|--|
| LEGALLY BINDING SECTION: | |
|-------------------------------------|--|

| | |
|----------------------------------|----------|
| What this Ruling is about | 1 |
|----------------------------------|----------|

| | |
|-----------------------|-----------|
| Date of effect | 11 |
|-----------------------|-----------|

| | |
|---------------|-----------|
| Ruling | 16 |
|---------------|-----------|

| | |
|---------------|-----------|
| Scheme | 17 |
|---------------|-----------|

| | |
|---|--|
| NOT LEGALLY BINDING SECTION: | |
|---|--|

| | |
|--------------------|--|
| Appendix 1: | |
|--------------------|--|

| | |
|--------------------|-----------|
| Explanation | 32 |
|--------------------|-----------|

| | |
|--------------------|--|
| Appendix 2: | |
|--------------------|--|

| | |
|-------------------------------|-----------|
| Detailed contents list | 81 |
|-------------------------------|-----------|

❶ 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 in accordance with the fixed term instalment benefit payment type with the Value Protector Option to policy owners, or their nominated beneficiaries, under the OneCare Policy offered by OnePath Life Limited (OnePath Life) in respect of Life Cover, Total and Permanent Disability (TPD) Cover and/or Trauma Cover.
3. This Product Ruling does not:
 - address the tax consequences to arise in respect of the following types of cover offered under the OneCare Policy:
 - Income Secure Cover;
 - Business Expense Cover;
 - Living Expense Cover;
 - Child Cover; and
 - Extra Care Cover;
 - address the tax consequences to arise where the amount insured is required to be paid under:
 - the lump sum benefit payment type;
 - the age-based term instalment benefit payment type; or
 - the fixed term instalment benefit payment type without the Value Protector Option;¹
 - address the deductibility of the cost of the Value Protector Option;
 - address the tax consequences to arise in respect of the acquisition of a OneCare Super Policy;

¹ The tax consequences to arise where the amount insured is required to be paid under the age-based term instalment benefit payment type and the fixed term instalment benefit payment type without the Value Protector Option is addressed in Product Ruling PR 2012/24 for the class of entities set out under paragraphs 4 to 6 of that Ruling.

- address the tax consequences upon the assignment or transfer of the ownership of the OneCare Policy to another person; and
- apply to any benefits and options available at extra cost under the OneCare Policy, other than the Value Protector Option.

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 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) issued with a OneCare Policy by OnePath Life on or after 1 July 2012 and on or before 30 June 2015 and individuals (not acting in a trustee capacity) nominated as beneficiaries by such policy owners, who are entitled to receive the amount insured in respect of Life Cover, where:
 - (a) the amount insured is required to be paid under the fixed term instalment benefit payment type;
 - (b) the policy owner makes a choice to apply the Value Protector Option;
 - (c) the cover does not represent 'key man' and other similar insurance covered by Taxation Ruling IT 155; and
 - (d) the policy does not support a 'buy/sell', share purchase or business succession agreement, and/or
- individuals (not acting in a trustee capacity) issued with a OneCare Policy by OnePath Life on or after 1 July 2012 and on or before 30 June 2015 and who are entitled to receive the amount insured in respect of TPD Cover or Trauma Cover, where:
 - (a) the amount insured is required to be paid under the fixed term instalment benefit payment type;
 - (b) the policy owner makes a choice to apply the Value Protector Option;
 - (c) 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));

- (d) the cover does not represent 'key man' and other similar insurance covered by Taxation Ruling IT 155; and
- (e) the policy does not support a 'buy/sell', share purchase or business succession agreement.

6. The class of entities who can rely on the Ruling section of this Product Ruling does **not** include entities that do not satisfy paragraph 5 of this Product Ruling.

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 31 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.

10. This work is copyright. Apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to:

Commonwealth Copyright Administration
Copyright and Classification Policy Branch
Attorney-General's Department
3-5 National Circuit
Barton ACT 2600

or posted at: <http://www.ag.gov.au/cca>

Date of effect

11. This Product Ruling applies 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 31 of this Ruling:

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

- (b) Monthly payments under the fixed term instalment benefit payment type received by a policy owner under the Life Cover, TPD Cover and/or Trauma Cover, or by a nominated beneficiary under the Life Cover, will not be included in the assessable income of the policy owner or beneficiary in any year of income under section 27H of the *Income Tax Assessment Act 1936* (ITAA 1936).
- (c) Monthly payments under the fixed term instalment benefit payment type received by a policy owner under the Life Cover, TPD Cover and/or Trauma Cover, or by a nominated beneficiary under the Life Cover, will not be included in the assessable income of the policy owner or beneficiary in any year of income under section 15-30.
- (d) Monthly payments under the fixed term instalment benefit payment type received by a policy owner under the Life Cover, TPD Cover and/or Trauma Cover, or by a nominated beneficiary under the Life Cover, will not be included in the assessable income of the policy owner or beneficiary in any year of income under section 230-15.
- (e) No part of the monthly payments under the fixed term instalment benefit payment type received by a policy owner under the Life Cover, TPD Cover and/or Trauma Cover, or by a nominated beneficiary under the Life Cover, 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.
- (f) A capital gain or capital loss made by a policy owner as a result of OnePath Life making a fixed term instalment benefit payment in respect of TPD Cover and/or Trauma Cover will be disregarded under paragraph 118-37(1)(b) 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).
- (g) A capital gain or capital loss made by a policy owner, or nominated beneficiary, as a result of OnePath Life making a fixed term instalment benefit payment in respect of Life Cover will be disregarded under section 118-300.
- (h) No deduction under section 8-1 will be available to a policy owner for premiums incurred in respect of Life Cover, TPD Cover and/or Trauma Cover.

- (i) 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 a policy owner or 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 17 December 2012 and 8 January 2013;
- OneCare Product Disclosure Statement dated 26 May 2012 and the Supplementary Product Disclosure Statement referred to in paragraph 26 of this Product Ruling;
- OneCare Policy Terms dated 26 May 2012 and Amendments to OneCare Policy Terms referred to in paragraph 26 of this Product Ruling; and
- OneCare Product Specification Version 1.3 dated 16 November 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 a policy owner or beneficiary, or any associate of a policy owner or beneficiary, will be a party to, which are a part of the scheme.

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

Overview

20. In its capacity as an insurance company, OnePath Life issues the OneCare Policy offering a range of insurance covers, including:

- Life Cover, when a life insured dies or is diagnosed as Terminally ill,²
- TPD Cover, when a life insured becomes totally and permanently disabled;

² Terminal illness means an illness that, in the opinion of an appropriate specialist physician approved by OnePath Life, is likely to lead to the death of the life insured within 12 months from the date that the opinion is provided.

- Trauma Cover, when a life insured suffers a specified trauma condition, as diagnosed and certified by a medical practitioner and agreed to by OnePath Life; and
- a combination of these covers.

21. The benefits under the OneCare Policy, referred to as the 'amount insured', are generally paid by OnePath Life to the policy owner or owners who have been issued with a OneCare Policy if a claim is payable under the Policy.

22. However, where the policy owner and the life insured are the same under the Life Cover, the policy owner can nominate one or more beneficiaries to receive the amount insured in the event of the policy owner's death. If no beneficiary is nominated, the amount insured is paid to the policy owner's estate.

23. The amount insured is an amount agreed between the policy owner and OnePath Life within the range of amounts specified for each cover, payable upon the happening of a specified event. The amount insured payable under the Life, TPD and Trauma Covers does not include investment income or an accruals component from the investment of the premium.

24. On application, there is a requirement on the policy owner of a OneCare Policy to nominate which of the two available benefit payment types they would like the amount insured to be paid under the Life, TPD or Trauma Covers. The two benefit payment types are the 'instalment benefit payment type' and the 'lump sum benefit payment type'.

25. Where the instalment benefit payment type has been selected by the policy owner, OnePath Life is required to pay the amount insured monthly in arrears from the date the entitlement arises over either a fixed term period specified in years (3, 5, 10 or 15 years), or an age-based term calculated by reference to the age of the life insured.

26. Where the policy owner nominates a fixed term instalment benefit payment type, they may apply the Value Protector Option available under the Supplementary Product Disclosure Statement (and set out in the Amendments to OneCare Policy Terms) to the amount insured at extra cost. Under the Value Protector Option the amount insured is indexed by the relevant CPI applying at the time whilst the insured is not on claim and increased each year by 3% when the insured is on claim.

27. Under the lump sum benefit payment type OnePath Life is required to pay the amount insured in one payment.

28. Subject to OnePath Life's agreement, the benefit payment type selected can be changed upon request, but not at the time of a claim or at any time when entitlement to make a claim arises.

29. A OneCare Policy can be continued each year upon the payment of premiums by the policy owner to OnePath Life in full for each life insured.

30. The OneCare Policy does not have a surrender value.

Assumptions

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

- (a) the policy owner(s) and nominated beneficiary or beneficiaries are individual Australian residents for taxation purposes;
- (b) where the policy owner is the life insured, they will nominate one or more beneficiaries to receive a total of 100% of the amount insured under the Life Cover;
- (c) the policy owner and nominated beneficiary will not make an election under subsection 230-455(7) to have Division 230 apply;
- (d) all dealings between the policy owner, nominated beneficiary and OnePath Life will be at arm's length; and
- (e) 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

17 April 2013

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.***

Payments under the fixed term instalment benefit payment type not assessable as ordinary income under section 6-5

32. 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.

33. 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 (*Slaven*). 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*).

34. Whether the receipt of the amount insured in regular or periodic instalments (rather than in a lump sum) 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.

35. The characterisation to be accorded to payments of the amount insured under the fixed term 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 the OneCare Policy with the intention to receive the amount insured on the happening of a specified event. The amount insured is intended not to compensate the policy owner or the nominated beneficiary for the loss of earnings but for the loss of earning capacity of the life insured, and would therefore not be ordinary income.

36. The payments of the amount insured under the fixed term 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*.

37. 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 ...

38. 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.

39. The calculation of the payments of the amount insured under the fixed term instalment benefit payment type has no relationship to the amount of earnings of the life insured.

40. The payments of the amount insured under the fixed term 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.

41. 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, any fixed term instalment benefit payment type payments paid monthly in substitution for a capital payment retains its capital characterisation.

42. Accordingly, the payments of the amount insured under the fixed term instalment benefit payment type under the Life, TPD and/or Trauma Covers to the policy owner, or under the Life Cover to the nominated beneficiary, are capital receipts, and are not assessable under section 6-5 as ordinary income.

Payments under the fixed term instalment benefit payment type not an annuity

43. 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.

44. The word 'annuity' is defined in subsection 27H(4) of the ITAA 1936 to mean an annuity, a pension paid from a foreign superannuation fund (within the meaning of the ITAA 1997) or a pension paid from a scheme mentioned in paragraph 290-5(c) of the ITAA 1997, but does not include an annuity that is a qualifying security for the purposes of Division 16E of the ITAA 1936 or a superannuation income stream (within the meaning of the ITAA 1997).

45. As the statutory definition of an annuity is not exhaustive, the common law meaning of the term is of relevance. 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.

46. 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 ...

47. 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.

48. The terms of the OneCare Policy provide that upon the happening of a specified event OnePath Life has a liability of a capital sum to the policy owner or the nominated beneficiary. The mere fact that the liability has to be paid out in instalments where the policy owner chooses the fixed term instalment benefit payment type to apply does not convert the payments into annuity payments. The amount insured, which is the source of the instalment payments, represents a debt owed by OnePath Life, as the insurance company, to the policy owner or to the nominated beneficiary, as applicable. 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.

49. 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 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.

50. 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 OnePath Life to make a capital payment. The fixed term instalment benefit payment type is simply a means adopted by OnePath Life to liquidate the obligation. The monthly payments of the amount insured are in lieu of payment of the amount insured as a capital lump sum. Lastly, under the OneCare Policy Terms, the policy owner may be able to cancel the condition for payment under the fixed term instalment benefit payment type before the happening of an event.

51. These factors all lead to the conclusion that the payments of the amount insured under the fixed term instalment benefit payment type are not an annuity and will not be assessable to either the policy owner or nominated beneficiary, as applicable, under section 27H of the ITAA 1936.

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

52. 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.

53. Payments of the amount insured under the fixed term instalment benefit payment type are payments received by way of insurance.

54. 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 *Inkster 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.

55. The payments of the amount insured under the fixed term instalment benefit payment type are for the loss of the life insured's earning capacity, and not for the loss of income. Therefore, any payment received does not fall to be assessed under section 15-30.

Payments under the fixed term instalment benefit payment type not assessable under section 230-15

56. Division 230 sets out the tax treatment of gains or losses from a 'financial arrangement'. Generally, a financial arrangement is a cash settleable 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 'settable' 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.

57. The OneCare Policy constitutes a financial arrangement for the purposes of Division 230 on the basis that the policy owner and/or the nominated beneficiary have cash settleable rights to receive a financial benefit in the form of monthly payments of the amount insured on the happening of a specified event, and on the basis that the policy owner has a cash settleable obligation to provide a financial benefit in the form of premiums.

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

59. However, where an arrangement is not a qualifying security for the purposes of Division 16E of the ITAA 1936 (see paragraph 62 of this Product Ruling) and an election under section 230-455 to have Division 230 of the ITAA 1997 apply to financial arrangements has not been made, then pursuant to subsection 230-455(1) of the ITAA 1997, Division 230 of the ITAA 1997 does not apply in relation to gains or losses from a financial arrangement held by an individual.

Payments under the fixed term instalment benefit payment type not subject to the 'accruals assessability' under Division 16E of Part III

60. 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.

61. A qualifying security is defined in subsection 159GP(1) of Division 16E of the ITAA 1936. For the purposes of determining whether an arrangement is a qualifying security, that arrangement must be a security, also defined in subsection 159GP(1) to mean:

- (a) stock, a bond, debenture, certificate of entitlement, bill of exchange, promissory note or other security;
- (b) a deposit at bank or other financial institution;

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

62. The OneCare Policy is not considered to have sufficient debt like obligations to be a contract to which paragraph (d) of the definition of security in subsection 159GP(1) of the ITAA 1936 applies, nor does it fall within paragraphs (a), (b) or (c) of that definition. Therefore, the OneCare Policy does not meet the definition of security under subsection 159GP(1) and, as such, is not a qualifying security for the purposes of Division 16E.

63. As the OneCare Policy is not a qualifying security Division 16E of Part III of the ITAA 1936 has no application and no part of the amount insured is assessable on an accruals basis under section 159GQ of the ITAA 1936.

Capital gain or loss from payments under the OneCare Policy disregarded

64. 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 policy owner and nominated beneficiary under the OneCare Policy are legally enforceable rights and therefore a CGT asset according to the definition in subsection 108-5(1).

65. Where OnePath Life makes a monthly payment of the amount insured under the fixed term instalment benefit payment type in satisfaction of the policy owner's or nominated beneficiary's contractual rights under the OneCare Policy, their ownership of those rights are partly discharged or satisfied. Each partial discharge or satisfaction of the contractual rights gives rise to CGT event C2 (paragraph 104-25(1)(b)).

66. The policy owner or, where the policy owner is the life insured, the nominated beneficiary in the event of the policy owner's 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 – TPD and Trauma Cover

67. Section 118-37 disregards a capital gain or capital loss made by an individual relating to compensation or damages received by that individual as a result of any wrong, injury or illness they or their relative suffered personally.

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

69. Section 995-1(1) defines a 'relative' of a person as:

- (a) the person's spouse; or
- (b) the parent, grandparent, brother, sister, uncle, aunt, nephew, niece, lineal descendent or adopted child of that person, or of that person's spouse; or
- (c) the spouse of a person referred to in paragraph (b).

70. Any capital gain or capital loss the policy owner makes under section 104-25 upon payment of the amount insured for TPD or Trauma Cover by OnePath Life under the OneCare Policy in respect of the total and permanent disablement or trauma suffered by the life insured will be disregarded under paragraph 118-37(1)(b) where the life insured is:

- (a) the policy owner (that is, where the policy owner has suffered the wrong, injury or illness personally); or
- (b) a relative of the policy owner (that is, where the wrong, illness or injury has been suffered personally by a relative of the policy owner).

Section 118-300 – Life Cover

71. 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).³

72. Item 3 of the table in subsection 118-300(1) provides that a capital gain or capital loss made from a CGT event happening in relation to a CGT asset that is an interest in rights under a life insurance policy is disregarded where that CGT event happens to the original beneficial owner of the policy.

³ 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?*

73. The 'original beneficial owner' of any of the rights, or any interest in any of the rights, under a policy of life assurance is defined in Taxation Determination TD 94/31 to mean the first person who:

- (i) at the time the policy is effected, holds such rights, or any interest in such rights, and
- (ii) possesses all the normal incidents of beneficial ownership (for example, is entitled to the benefits of the policy proceeds and has the power of management and control over the policy as well as the power to transfer, grant as security, surrender or otherwise dispose of, the policy).

Where two or more persons jointly affect a policy of life assurance, each person may be an original beneficial owner.

74. As an individual to whom the Life Cover is first issued, the policy owner is regarded as an original beneficial owner of a policy of insurance on the life of an individual. Accordingly, the policy owner will be entitled under item 3 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 the amount insured for Life Cover by OnePath Life under the OneCare Policy.

75. 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 life insurance policy is disregarded where that CGT event happens to an entity that acquired the interest in the policy for no consideration.

76. A person nominated by the policy owner, being the nominated beneficiary, to receive the amount insured for Life Cover in the event of the death of the policy owner acquires, on the death of the policy owner, an interest in the OneCare 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 the amount insured for Life Cover by OnePath Life under the OneCare Policy.

Premiums not deductible

77. 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).

78. 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.

79. As the payments of the amount insured under the fixed term instalment benefit payment type are not intended to compensate for the loss of earnings of the life insured but are intended to compensate for the loss of earning capacity of the life insured they are treated as capital. The premiums are not incurred in gaining or producing assessable income 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 64 of this Product Ruling (subsections 110-25(2) and 110-55(2)).

Part IVA – anti-avoidance

80. 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

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

| | Paragraph |
|--|------------------|
| What this Ruling is about | 1 |
| Class of entities | 4 |
| Superannuation Industry (Supervision) Act 1993 | 7 |
| Qualifications | 8 |
| Date of effect | 11 |
| Changes in the law | 13 |
| Note to promoters and advisers | 15 |
| Ruling | 16 |
| Scheme | 17 |
| Overview | 20 |
| Assumptions | 31 |
| Appendix 1 – Explanation | 32 |
| Payments under the fixed term instalment benefit payment type not assessable as ordinary income under section 6-5 | 32 |
| Payments under the fixed term instalment benefit payment type not an annuity | 43 |
| Payments under the fixed term instalment benefit payment type not assessable as statutory income under section 15-30 | 52 |
| Payments under the fixed term instalment benefit payment type not assessable under section 230-15 | 56 |
| Payments under the fixed term instalment benefit payment type not subject to the 'accruals assessability' under Division 16E of Part III | 60 |
| Capital gain or loss from payments under the OneCare Policy disregarded | 64 |
| <i>Section 118-37 – TPD and Trauma Cover</i> | 67 |
| <i>Section 118-300 – Life Cover</i> | 71 |
| Premiums not deductible | 77 |
| Part IVA – anti-avoidance | 80 |
| Appendix 2 – Detailed contents list | 81 |

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

IT 155; TD 94/31; TD 2007/4

Subject references:

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

Legislative references:

- ITAA 1936 26(j)
- ITAA 1936 27H
- ITAA 1936 27H(4)
- ITAA 1936 51(1)
- ITAA 1936 Div 16E
- ITAA 1936 159GP(1)
- ITAA 1936 159GP(1)(a)
- ITAA 1936 159GP(1)(b)
- ITAA 1936 159GP(1)(c)
- ITAA 1936 159GP(1)(d)
- ITAA 1936 159GQ
- ITAA 1936 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 118-37
- ITAA 1997 118-37(1)(b)
- ITAA 1997 118-300
- ITAA 1997 118-300(1)
- ITAA 1997 Div 230
- ITAA 1997 230-15
- ITAA 1997 230-15(1)
- ITAA 1997 230-45(1)
- ITAA 1997 230-45(2)
- ITAA 1997 Subdiv 230-H

- ITAA 1997 230-455
- ITAA 1997 230-455(1)
- ITAA 1997 230-455(7)
- ITAA 1997 290-5(c)
- ITAA 1997 995-1(1)
- SISA 1993
- TAA 1953
- Copyright Act 1968

Case references:

- Australia & New Zealand Savings Bank Limited v. Federal Commissioner of Taxation (1993) 114 ALR 673; (1993) 25 ATR 369; 93 ATC 4370
- Case X21, AAT case 5617 (1990) 21 ATR 3157; 90 ATC 239
- Chadwick v. Pearl Life Insurance [1905] 2 KB 507
- 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. Inkster (1989) 89 ALR 137; (1989) 20 ATR 1516; 89 ATC 5142
- 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
- Scoble v. Secretary of State in Council for India [1903] 1 KB 494
- Tinkler v. FC of T (1979) 29 ALR 663; (1979) 10 ATR 411; 79 ATC 4641
- Watkins v. Deputy Commissioner of Taxation (1946) 49 WALR 63; (1946) 3 AITR 263; (1946) 8 ATD 78

ATO references

NO: 1-4FR43ZR

ISSN: 1441-1172

ATOlaw topic: Income Tax ~~ Product ~~ finance

