


PR 2015/10 - Income tax: Challenger CarePlus

 This cover sheet is provided for information only. It does not form part of *PR 2015/10 - Income tax: Challenger CarePlus*

 This document has changed over time. This is a consolidated version of the ruling which was published on *26 September 2018*



Product Ruling

Income tax: Challenger CarePlus

Contents	Para
LEGALLY BINDING SECTION:	
What this Ruling is about	1
Date of effect	10
Ruling	15
Scheme	16
NOT LEGALLY BINDING SECTION:	
Appendix 1:	
<i>Explanation</i>	36
Appendix 2:	
<i>Detailed contents list</i>	97

ⓘ 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.

[Note: *This is a consolidated version of this document. Refer to the Legal Database (<https://www.ato.gov.au/law>) to check its currency and to view the details of all changes.]*

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 1936* (ITAA 1936) unless otherwise indicated.
2. In this Product Ruling the scheme is an investment in Challenger CarePlus (CarePlus) offered by Challenger Life Company Limited (Challenger) under:
 - the Product Disclosure Statement dated 14 August 2015 (PDS), and
 - the Product Disclosure Statement dated 19 August 2016 (PDS).

All references to the 'PDS' in this Product Ruling are to be read as a reference to one of the two offer documents referred to above, as applicable. CarePlus is comprised of two products, being CarePlus Annuity (Annuity) and CarePlus Insurance (Insurance).

3. This Product Ruling does not address:
 - (a) the taxation consequences of acquiring, holding and disposing or redeeming the Annuity or Insurance, other than as per paragraphs 16 to 35 of this Product Ruling
 - (b) the taxation consequences from disposing or otherwise ending the Annuity other than upon death
 - (c) the taxation consequences from disposing or otherwise ending the Insurance other than by voluntary cancellation or upon death
 - (d) the taxation consequences for an Annuity purchased using a directed termination payment within the meaning of the *Income Tax (Transitional Provisions) Act 1997* (IT(TP)A 1997)
 - (e) the taxation consequences for an Annuity purchased using personal injury compensation money, as per Division 54 of the *Income Tax Assessment Act 1997* (ITAA 1997)
 - (f) a policy owner's eligibility to claim the Senior Australians and pensioners tax offset
 - (g) the deductibility of the amount invested to purchase the Annuity¹

¹ For the purposes of this Product Ruling, it is assumed at paragraph 35(e) that no portion of the amount invested to purchase the Annuity is deductible.

- (h) whether the regular payments made by Challenger to the policy owner under the Annuity are subject to Pay As You Go withholding tax
- (i) the treatment of any duties, tax or other government charges that may be deducted from the sum insured or the termination value payable by Challenger under the Insurance
- (j) the deductibility of adviser service fees, and
- (k) the taxation consequences of borrowing funds to purchase the Annuity or Insurance, including the deductibility of interest on funds borrowed.

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.

5. The class of entities who can rely on the Ruling section of this Product Ruling consists of those entities that are Australian residents for taxation purposes and are one of the following:

- (a) an individual policy owner (other than in the capacity of a trustee of a trust estate) who purchases the Annuity described in paragraphs 16 to 35 of this Product Ruling on or after 14 August 2015 and on or before 30 June 2018, referred to as the policy owner in this Product Ruling, and
- (b) where the policy owner referred to in paragraph 5(a) of this Product Ruling also purchases the Insurance^{1A} described in paragraphs 16 to 35 of this Product Ruling and dies without having voluntarily cancelled their Insurance:
 - (i) an individual (other than in the capacity of a trustee of a trust estate) nominated as a beneficiary by the policy owner, or
 - (ii) the deceased estate of the policy owner.

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

- (a) purchase the Annuity before 14 August 2015 or after 30 June 2018, or
- (b) purchase the Annuity using a directed termination payment within the meaning of the IT(TP)A 1997, or personal injury compensation money that is subject to Division 54 of the ITAA 1997.

^{1A} From 16 August 2016, policy owners must purchase both the Annuity and Insurance.

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 16 to 35 of this Ruling.

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

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

Date of effect

10. This Product Ruling applies prospectively from 14 August 2015. It therefore applies only to the specified class of entities that enter into the scheme from 14 August 2015 until 30 June 2018, 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.

11. 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

12. 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.

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

Note to promoters and advisers

14. Product Rulings were introduced for the purpose of providing certainty about tax consequences for entities in schemes such as this. In keeping with that intention the Commissioner suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Product Ruling has issued.

Ruling

15. Subject to paragraph 3 and the assumptions in paragraph 35 of this Ruling:

CarePlus Annuity

- (a) An Annuity purchased by the policy owner:
 - (i) is not a 'qualifying security' as defined in subsection 159GP(1)
 - (ii) is not a 'superannuation income stream' as defined in regulation 995-1.01 of the *Income Tax Assessment Regulations 1997* (ITAR), and
 - (iii) is an 'annuity' as defined in subsection 27H(4).
- (b) An Annuity purchased by the policy owner is not a financial arrangement to which Division 230 of the ITAA 1997 applies.
- (c) The regular payments made by Challenger to the policy owner are assessable income under subsection 27H(1) to the extent that the regular payments exceed the 'deductible amount' in relation to the Annuity. The deductible amount is excluded from the assessable amount of the Annuity.
- (d) The annual deductible amount in relation to the regular payments derived by the policy owner is ascertained (subject to subsection 27H(3)) in accordance with the formula set out in subsection 27H(2) on the basis that:
 - (i) the 'relevant share' in relation to the Annuity is 1
 - (ii) the 'undeducted purchase price' of the Annuity is the amount paid to purchase the Annuity
 - (iii) the 'residual capital value' in relation to the Annuity is nil, and
 - (iv) the 'relevant number' in relation to the Annuity is the life expectation factor of the life insured (that is, the policy owner), determined on the

commencement date of the Annuity in accordance with official Australian Life Tables.

- (e) Where the regular payments are not payable to the policy owner for the whole of an income year, the deductible amount for that year will be reduced proportionately by the Commissioner pursuant to subsection 27H(3) based on the part of the year during which the regular payments are not paid.
- (f) The amount of any reduction in the deductible amount described in paragraph 15(e) of this Product Ruling can be applied to regular payments derived by the policy owner in subsequent income years to the extent that those regular payments would otherwise exceed the deductible amount in those years.
- (g) Any capital gain made by the policy owner resulting from the regular payments made by Challenger is disregarded under section 118-300 of the ITAA 1997, and is not otherwise assessable as ordinary or statutory income under the ITAA 1997.

CarePlus Insurance

- (h) The premium paid by the policy owner to purchase the Insurance is not deductible under section 8-1 of the ITAA 1997.
- (i) The payment of the termination value by Challenger to the policy owner upon cancellation of their Insurance is not included in the assessable income of the policy owner pursuant to sections 6-5 or 230-15 of the ITAA 1997; or sections 26AH, 27H or 159GQ of the ITAA 1936.
- (j) Any capital gain or capital loss made by the policy owner resulting from the payment of the termination value by Challenger to them upon cancellation of their Insurance is disregarded under section 118-300 of the ITAA 1997.
- (k) The payment of the sum insured by Challenger to the nominated beneficiary or the deceased estate of the policy owner, as applicable, upon the death of the policy owner is not included in their assessable income pursuant to sections 6-5 or 230-15 of the ITAA 1997; or sections 26AH, 27H or 159GQ of the ITAA 1936.
- (l) Any capital gain or capital loss made by the nominated beneficiary or the deceased estate of the policy owner, as applicable, resulting from the payment of the sum insured by Challenger to them upon the death of the policy owner is disregarded under section 118-300 of the ITAA 1997.

Anti-avoidance provisions

- (m) Provided the scheme ruled on is entered into and carried out as described in this Product Ruling, the anti-avoidance provisions in Part IVA will not apply to the policy owner, their deceased estate or their nominated beneficiary.

Scheme

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

- application for a Product Ruling as constituted by documents and information received on 4 August 2014, 10 August 2015, 13 August 2015, 14 August 2015, 21 August 2015, 24 August 2015 and 9 July 2018
- Challenger CarePlus Product Disclosure Statement dated 14 August 2015, including the CarePlus Annuity Policy Document and the CarePlus Insurance Policy Document
- Challenger CarePlus Product Disclosure Statement dated 19 August 2016, including the CarePlus Annuity Policy Document and the CarePlus Insurance Policy Document, and
- Investor Certificates.

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

17. For the purposes of describing the scheme to which this Product Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which the policy owner, their beneficiary or their deceased estate, or any associate of the policy owner, their beneficiary or their deceased estate, will be a party to, which are a part of the scheme.

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

19. As part of its life insurance business, Challenger has issued CarePlus, comprised of two separate policies, the Annuity and the Insurance. On offer is investment in both the Annuity and the Insurance. Prior to 19 August 2016, policy owners could choose to purchase the Annuity without the Insurance.

20. To purchase the Annuity and (if applicable) the Insurance the policy owner is required, among other things, to execute and lodge

the application form attached to the PDS with Challenger, together with an investment amount of at least \$10,000. That investment amount (the CarePlus investment amount) is the total of the purchase price paid by the policy owner to acquire the Annuity and, where applicable, the one-off premium paid by the policy owner to purchase the Insurance. No additional fees or charges (including premiums) are payable to Challenger by the policy owner for the duration of the policies.

21. Upon acceptance of a valid application, for each policy acquired the policy owner is issued with separate Policy Documents (each a legal contract between the policy owner and Challenger) and separate Investor Certificates by Challenger, setting out the relevant terms and conditions.

22. The life insured under both the Annuity and the Insurance is the policy owner.

CarePlus Annuity

23. The Annuity is a 'life policy' for the purposes of the *Life Insurance Act 1995* (as per paragraph 9(1)(c) of that Act) which therefore satisfies the definition of a 'life insurance policy' under subsection 995-1(1) of the ITAA 1997.

24. The Annuity is offered by Challenger in Australia to individuals over 18 years of age who:

- have Aged Care Assessment Team approval² that specifies them as being eligible to receive Government-subsidised aged care services (including home care), or
- live in an approved residential aged care facility.

25. Individuals who purchase the Annuity cannot do so using a 'roll-over superannuation benefit' (as defined in section 306-10 of the ITAA 1997), or jointly with another person.

26. In exchange for the investment amount used to purchase the Annuity, the Annuity provides regular payments for the policy owner's lifetime at an agreed frequency (monthly, quarterly, half-yearly or yearly, as chosen at the time the Annuity is purchased).

27. The amount of the regular payments is fixed for the duration of the policy, determined at the time the Annuity is purchased and depends on a number of factors, including the amount of the initial investment, prevailing market rates, the policy owner's life expectancy at the time of purchase and, where relevant (as per paragraph 31 of this Product Ruling), the level of cover chosen by the policy owner under their Insurance.

² Or Aged Care Assessment Service approval in Victoria.

28. The policy owner cannot withdraw from the Annuity at any time following its commencement and the Annuity does not have a withdrawal value (either upon commutation or death). The Annuity will cease, together with the regular payments, on the death of the policy owner.

CarePlus Insurance

29. The Insurance is a 'life policy' for the purposes of the *Life Insurance Act 1995* (as per paragraph 9(1)(a) of that Act) which therefore satisfies the definition of a 'life insurance policy' under subsection 995-1(1) of the ITAA 1997.

30. The Insurance can only be purchased by the policy owner where they have purchased the Annuity at the same time.

31. Upon the death of the policy owner, Challenger will pay a fixed lump sum amount (the sum insured) either to one or more beneficiaries nominated by the policy owner or, where a valid nomination has not been made, to the policy owner's deceased estate. The sum insured, as specified in the CarePlus Insurance Investor Certificate issued to the policy owner, is determined at the time the Insurance is purchased and will be equal to 100% of their CarePlus investment amount or, for policy owners who purchased the Insurance prior to 16 August 2016, equal to either 50% or 100% of their CarePlus investment amount depending on their choice.

32. The sum insured payable under the Insurance does not include investment income or an accruals component from the investment of the premium.

33. The policy owner has the right to cancel their Insurance at any time. On cancellation the policy owner will be paid a termination value³ by Challenger, the calculation of which is subject to a minimum prescribed under the *Life Insurance Act 1995* and prudential standards enforced by the Australian Prudential Regulation Authority (APRA).

34. Cover under the Insurance will cease either on the death of the policy owner or the earlier cancellation of the policy.

Assumptions

35. This Ruling is made on the basis of the following assumptions:
- (a) the policy owner and the nominated beneficiary are individual Australian residents for taxation purposes

³ Stamp Duty will be deducted from the sum insured or the termination value, as appropriate, before being distributed by Challenger where the appropriate recipient resides in South Australia.

- and are not a taxation resident of a country with which Australia has concluded a double tax treaty
- (b) the policy owner's deceased estate is an Australian resident trust estate as defined in subsection 95(2) and is not a resident trust estate of a country with which Australia has concluded a double tax treaty
 - (c) the policy owner will not purchase the Annuity using a directed termination payment within the meaning of the IT(TP)A 1997, or using personal injury compensation money that is subject to Division 54 of the ITAA 1997
 - (d) the policy owner is the original policy owner who purchased the Annuity and, if applicable, the Insurance from Challenger for their own benefit
 - (e) no portion of the amount invested to purchase the Annuity is deductible
 - (f) all dealings between the policy owner, their beneficiary, their deceased estate and Challenger will be at arm's length, and
 - (g) the scheme will be executed in the manner described in the Scheme section of this Product Ruling and the scheme documentation referred to in paragraph 16 of this Ruling.

Appendix 1 – Explanation

ⓘ *This Appendix is provided as information to help you understand how the Commissioner’s view has been reached. It does not form part of the binding public ruling.*

CarePlus Annuity

Subsection 27H(4) – annuity

36. Subsection 27H(4) defines an ‘annuity’ to mean:

an annuity, a pension paid from a foreign superannuation fund (within the meaning of the *Income Tax Assessment Act 1997*) or a pension paid from a scheme mentioned in paragraph 290-5(c) of that Act, but does not include:

- (a) an annuity that is a qualifying security for the purposes of Division 16E; or
- (b) a superannuation income stream (within the meaning of the *Income Tax Assessment Act 1997*).

37. This definition encompasses an annuity on ordinary concepts, as contemplated within various judicial authorities and discussed in IT 2480.⁴ An annuity on ordinary concepts is a contract under which a principal sum is converted into an income stream⁵ of payments that are at least annual, fixed or variable in a way that is calculable, and which will continue to be paid for a fixed or determinable period.

38. The policy owner’s investment amount is applied to purchase the regular payments payable by Challenger under the terms of the Annuity, a contract between the policy owner and Challenger. Those regular payments are a series of periodic payments (payable at least yearly), fixed at the time of purchase and continue for the life of the policy owner.

39. An Annuity purchased by the policy owner therefore constitutes an annuity on ordinary concepts and, subject to the exclusions in paragraphs (a) and (b) of the definition (considered at paragraphs 40 to 45 of this Product Ruling), constitutes an annuity as defined in subsection 27H(4).

⁴ Taxation Ruling IT 2480 *Income tax: variable annuities*.

⁵ The term ‘income stream’ is defined in Taxation Ruling TR 2013/5 in the context of a superannuation income stream payable by a superannuation fund trustee to a member as ‘a series of periodic payments that relate to each other over an identifiable period of time’.

Division 16E – qualifying security

40. A 'qualifying security' is defined in subsection 159GP(1). 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 with a 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.

41. The Annuity 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) applies, nor does it fall within paragraphs (a), (b) or (c) of that definition. Therefore, the Annuity 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.

42. Additionally, an annuity will not be a qualifying security for the purposes of subsection 159GP(1) where it is an 'ineligible annuity', a term also defined in subsection 159GP(1) to mean 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. An Annuity issued by Challenger to the policy owner (that is, a natural person other than in the capacity of trustee of a trust estate) is an ineligible annuity.

Superannuation income stream

43. A 'superannuation income stream' has the meaning given by the ITAR (subsection 307-70(2) of the ITAA 1997). Subregulation 995-1.01(1) of the ITAR defines superannuation income stream in relation to an annuity commenced after 19 September 2007 to mean an income stream that is taken to be an annuity for the purposes of the SISA in accordance with subregulation 1.05(1) of the *Superannuation Industry (Supervision) Regulations 1994* (SISR).

44. Subregulation 1.05(1) of the SISR provides a number of requirements that must be met for a benefit provided by a life insurance company to be taken to be an annuity for the purposes of the SISA. One of those requirements in respect of a benefit purchased on or after 1 July 2007 is that it is purchased with the whole or part of a roll-over superannuation benefit as defined in section 306-10 of the ITAA 1997, or the whole or part of a directed termination payment within the meaning of the IT(TP)A 1997.

45. As per paragraph 25 of this Product Ruling, the policy owner cannot purchase the Annuity using a roll-over superannuation benefit as defined in section 306-10 of the ITAA 1997 and, as per paragraph 35(c) of this Product Ruling, it is assumed for the purposes of this Ruling that the policy owner will not purchase the Annuity using a directed termination payment within the meaning of the IT(TP)A 1997. As such, the Annuity is not a superannuation income stream for the policy owner.

Division 230 – taxation of financial arrangements

46. Division 230 of the ITAA 1997 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 rights and/or obligations (subsection 230-45(1) of the ITAA 1997). A right to receive or obligation to provide a financial benefit can be 'cash settlable' under subsection 230-45(2) of the ITAA 1997 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.

47. The Annuity constitutes a financial arrangement for the purposes of Division 230 of the ITAA 1997 on the basis that the policy owner has cash settlable rights to receive a financial benefit in the form of the regular payments and on the basis that the policy owner has a cash settlable obligation to provide a financial benefit in the form of the purchase price of the Annuity.

48. Subject to exceptions under Subdivision 230-H of the ITAA 1997, gains made from a financial arrangement are included in assessable income under subsection 230-15(1) of the ITAA 1997 and are not (to any extent) to be included in assessable income pursuant to any other taxing provision of the ITAA 1997 (subsection 230-20(4) of the ITAA 1997), including section 27H of the ITAA 1936.

49. However, where the rights and/or obligations under an arrangement are the subject of an exception under section 230-460 of the ITAA 1997, Division 230 of the ITAA 1997 does not apply in relation to gains or losses from a financial arrangement for any income year (subsection 230-460(1) of the ITAA 1997). Subsection 230-460(5) of the ITAA 1997 provides a specific exception as follows:

A right or obligation under a *life insurance policy is the subject of an exception unless:

- (a) you are not a *life insurance company that is the insurer under the policy; and
- (b) the policy is an annuity that is a *qualifying security.

50. As the Annuity is a life insurance policy (as defined in subsection 995-1(1) of the ITAA 1997 and as per paragraph 23 of this Product Ruling) that is not a qualifying security (as defined in subsection 159GP(1) and discussed at paragraphs 40 to 42 of this Product Ruling), the exception in subsection 230-460(5) of the ITAA 1997 applies and Division 230 of the ITAA 1997 does not apply to any gains or losses derived from an Annuity purchased by the policy owner.

Section 27H – assessability of regular payments

51. Paragraph 27H(1)(a) includes in the assessable income of a taxpayer of a year of income the amount of any annuity derived by the taxpayer during that year excluding, in the case of an annuity that has been purchased, any amount that is the deductible amount in relation to the annuity in relation to the year of income. The regular payments made by Challenger to the policy owner are therefore assessable income under subsection 27H(1) to the extent that the regular payments exceed the deductible amount in relation to the Annuity.

52. The deductible amount is excluded from the assessable amount of the annuity and is tax free to the recipient because it represents the return to them of the amount paid to acquire the annuity. Subsection 27H(2) provides for the calculation of the deductible amount in relation to an annuity derived by a taxpayer during a year of income, subject to subsections 27H(3) and (3A), in accordance with the following formula:

$$\frac{A (B - C)}{D}$$

where:

A is the relevant share in relation to the annuity in relation to the taxpayer in relation to the year of income.

B is the amount of the undeducted purchase price of the annuity.

C is:

- (a) if there is a residual capital value in relation to the annuity and that residual capital value is specified in the agreement by virtue of which the annuity is payable or is capable of being ascertained from the terms of that agreement at the time when the annuity is first derived – that residual capital value, or
- (b) in any other case – nil, and

D is the relevant number in relation to the annuity.

53. The relevant share in relation to the Annuity (component A) for the policy owner is 1.

54. The undeducted purchase price in relation to an Annuity (component B) that is purchased by the policy owner is the whole of the purchase price of the Annuity, reduced by any portion of the purchase price that is an allowable deduction. As per paragraph 35(e) of this Product Ruling, it is assumed for the purposes of this Ruling that no portion of the amount invested to purchase the Annuity is deductible.

55. The residual capital value in relation to an annuity is defined in subsection 27H(4) to mean the capital amount payable on the termination of the annuity. As the terms of the Annuity do not provide for any residual capital value in relation to the Annuity, it (component C) is nil.

56. Where an annuity is payable during the lifetime of a person and not thereafter, the relevant number in relation to that annuity in relation to a year of income is defined in subsection 27H(4) to mean the life expectation factor of the person. The relevant number in relation to the Annuity (component D) is therefore the life expectation factor of the policy owner. The life expectation factor in relation to a person in relation to an annuity is defined in subsection 27H(4) to mean the number of years in the complete expectation of life of the person as ascertained by reference to the prescribed Life Tables⁶ at the time at the beginning of the period to which the first payment of the annuity relates.

57. Where the Commissioner considers that the deductible amount ascertained in accordance with the formula in subsection 27H(2) is inappropriate, having regard to the terms and conditions applying to the annuity and to any other relevant matters, he may, subject to subsection 27H(3A), determine the deductible amount that applies pursuant to subsection 27H(3). In making a determination pursuant to subsection 27H(3), the Commissioner may have regard to the terms and conditions applying to the annuity, to a certificate supplied by an actuary and to any other matters considered relevant.

58. Paragraphs 16 to 24 of IT 2157⁷ provide some guidelines as to the exercise of the discretion under subsection 27H(3). Applying those guidelines to the Annuity, the Commissioner may exercise the discretion under subsection 27H(3) where the regular payments are not payable for the whole of an income year, in which case the deductible amount ascertained under subsection 27H(2) will be inappropriate and reduced proportionately based on the part of the year during which the regular payments are not paid.

59. As the Annuity cannot be partly commuted, subsection 27H(3A) cannot have any application on the determination of the deductible amount in relation to the Annuity.

⁶ For the purposes of the definition of 'life expectation factor' in subsection 27H(4) and with respect to annuities first commencing to be payable on or after 1 July 1993, regulation 7 table item 4 of the *Income Tax Assessment (1936 Act) Regulation 2015* prescribes the Australian Life Tables that are most recently published by the Australian Government Actuary before the year in which the annuity first commences to be payable.

⁷ Taxation Ruling IT 2157 *Income tax: assessment of Annuities Eligible Termination Payments – Commutation of Annuities – Commonwealth Superannuation Act.*

Capital gain or loss from regular payments under the Annuity disregarded

60. Under subsection 108-5(1) of the ITAA 1997 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 under the Annuity are legally enforceable rights and therefore a CGT asset according to the definition in subsection 108-5(1) of the ITAA 1997. Generally, the discharge or satisfaction of contractual rights gives rise to a CGT event C2 (paragraph 104-25(1)(b) of the ITAA 1997).

61. Section 118-300 of the ITAA 1997 exempts certain capital gains and losses made in respect of a policy of insurance on the life of an individual or an annuity instrument. An annuity instrument is defined broadly in subsection 995-1(1) of the ITAA 1997 to mean an instrument that secures the grant of an annuity (whether dependent on the life of an individual or not).

62. Item 3 of the table in subsection 118-300(1) of the ITAA 1997 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 an annuity instrument is disregarded where that CGT event happens to the original owner of the instrument (other than the trustee of a complying superannuation entity).

63. As an individual to whom the Annuity is first issued, the policy owner is regarded as an original owner of an annuity instrument. Pursuant to item 3 in the table in subsection 118-300(1) of the ITAA 1997, any capital gain or capital loss the policy owner makes under section 104-25 of the ITAA 1997 from the receipt of regular payments by Challenger under the Annuity is therefore disregarded.

CarePlus Insurance**Premium not deductible**

64. 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 *Federal Commissioner of Taxation v. DP Smith* (1981) 147 CLR 578; 81 ATC 4114; (1981) 11 ATR 538, Gibbs, Stephen, Mason, and Wilson JJ held at CLR 585; ATC 4117; ATR 542 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 sec 51(1).

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

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.

66. As the payment of the sum insured under the Insurance is intended to compensate for the loss of the life insured it is treated as capital (see paragraphs 68 to 70 of this Product Ruling). The premium is therefore not incurred in gaining or producing assessable income and is not deductible under section 8-1 of the ITAA 1997.

Payment of the sum insured not assessable as ordinary income under section 6-5

67. Section 6-5 of the ITAA 1997 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.

68. The characterisation to be accorded to the sum insured payable under the Insurance will depend on the purpose of the payment and the circumstances of its receipt: *Tinkler v. Federal Commissioner of Taxation* (1979) 29 ALR 663; 79 ATC 4641; (1979) 10 ATR 411 per Brennan J at ALR 667; ATR 414; ATC 4644. Under the Insurance the policy owner takes out a policy with the intention for their nominated beneficiary or deceased estate to receive the sum insured on the happening of the death of the policy owner. The sum insured is intended to compensate the policy owner's beneficiary or deceased estate, as applicable, for the loss of earning capacity of the policy owner (as the life insured).

69. 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; 84 ATC 4077; (1984) 15 ATR 242. Such payments are capital in nature.

70. Accordingly, the payment of the sum insured under the Insurance to the nominated beneficiary or the deceased estate of the policy owner, as applicable, is a capital receipt, and is not assessable under section 6-5 of the ITAA 1997 as ordinary income.

Payment of the termination value not assessable as ordinary income under section 6-5

71. Ordinary income has generally been held to include three categories, namely income rendering personal services, income from property and income from carrying on a business. Other characteristics of ordinary income that have evolved from case law include receipts that are earned, expected, relied upon, and have an element of periodicity, recurrence or regularity.

72. The payment of the termination value (a lump sum) to the policy owner on cancellation of their Insurance does not relate to any of the three categories identified in paragraph 71 of this Product Ruling. Whilst the termination value can be said to be expected and may be relied upon, it is not earned, and does not have an element of periodicity, recurrence or regularity.

73. Accordingly, the payment of the termination value under the Insurance to the policy owner, a receipt which relates to the personal circumstances of the policy owner, is not assessable under section 6-5 of the ITAA 1997 as ordinary income.

Payments under the Insurance not assessable under section 230-15

74. The Insurance constitutes a financial arrangement for the purposes of Division 230 of the ITAA 1997 on the basis that the policy owner and/or the nominated beneficiary or deceased estate of the policy owner have cash settlable rights to receive a financial benefit in the form of the termination value and the sum insured, as appropriate, on the happening of a specified event, and on the basis that the policy owner has a cash settlable obligation to provide a financial benefit in the form of the premium.

75. Subject to exceptions under Subdivision 230-H of the ITAA 1997, gains made from a financial arrangement are included in assessable income under subsection 230-15(1) of the ITAA 1997.

76. As the Insurance is a life insurance policy (as defined in subsection 995-1(1) of the ITAA 1997 and as per paragraph 29 of this Product Ruling) that is not an annuity that is a qualifying security (as discussed at paragraphs 82 to 87 of this Product Ruling), the exception in subsection 230-460(5) of the ITAA 1997 applies and Division 230 of the ITAA 1997 does not apply to any gains or losses derived by the policy owner from the cancellation of their Insurance, or by the policy owner's beneficiary or deceased estate upon the death of the policy owner.

Payments under the Insurance not assessable under section 26AH

77. Subsection 26AH(6) includes all or part of amounts received as or by way of bonuses under certain life assurance policies,⁸ which but for section 26AH would not be included in the assessable income of the recipient, in the assessable income of the recipient when received within ten years of the date on which the first or only premium paid under the policy was paid.

78. The term 'bonus' is not defined for the purposes of section 26AH but is explained at paragraph 8 of IT 2346⁹ in the context of 'more traditional policies' as a guaranteed addition to the amount insured, payable when the amount insured is payable and representing both a form of participation by the policy holder in the issuing company's profits and a share in the surpluses derived by the issuing company during the period the policy is in force. Relevantly, the Life Insurance Prudential Standards similarly define the term 'bonus' at LPS 001 to mean 'an amount of profit added at the discretion of a life company (including additions in respect of investment experience) to the benefits due under a participating benefit, but excluding any guaranteed rate of addition also applicable to the benefit'.

79. As the payment of the termination value to the policy owner upon cancellation of their Insurance will equate to the minimum surrender value prescribed under the *Life Insurance Act 1995* and APRA prudential standards, and will not contain any element of profit of Challenger, the termination value cannot be characterised as a bonus.

80. Similarly, as the payment of the sum insured to either the policy owner's beneficiary or deceased estate, as applicable, is the payment of a predetermined amount due under the Insurance upon the death of the policy owner, and will not contain any element of profit of Challenger, the sum insured cannot be characterised as a bonus. Furthermore, subsection 26AH does not apply to include in assessable income an amount received under a life assurance policy in consequence of the death of the person insured (paragraph 26AH(7)(a)).

81. For the reasons stated in paragraphs 79 and 80 of this Product Ruling, subsection 26AH(6) does not apply to include either the termination value or the sum insured in the assessable income of the recipient.

⁸ A life assurance policy is defined in section 6 of the ITAA 1936 as having the meaning given to 'life insurance policy' by the ITAA 1997.

⁹ Taxation Ruling IT 2346 *Income tax: bonuses paid on certain life assurance policies – section 26AH – interpretation and operation.*

Payments under the Insurance not assessable under section 27H

82. As per paragraph 51 of this Product Ruling, section 27H 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.

83. Paragraphs 36 and 37 of this Product Ruling set out what constitutes an annuity for the purposes of section 27H. The payments of the termination value or the sum insured under the Insurance are not an annuity and will not be assessable to either the policy owner or their nominated beneficiary or deceased estate, as applicable, under section 27H.

Payments under the Insurance not subject to the 'accruals assessability' under Division 16E of Part III

84. Division 16E of Part III 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.

85. As mentioned in paragraph 40 of this Product Ruling, for the purposes of determining whether an arrangement is a qualifying security as defined in subsection 159GP(1), that arrangement must be a security, also defined in subsection 159GP(1).

86. The Insurance 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) applies, nor does it fall within paragraphs (a), (b) or (c) of that definition. Therefore, the Insurance 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.

87. As the Insurance is not a qualifying security Division 16E of Part III has no application and no part of the termination value or the sum insured is assessable on an accruals basis under section 159GQ.

Capital gain or loss from payments under the Insurance disregarded

88. The contractual rights of the policy owner and, as applicable, the policy owner's nominated beneficiary or deceased estate under the Insurance are legally enforceable rights and therefore a CGT asset according to the definition in subsection 108-5(1) of the ITAA 1997.

89. Where Challenger makes a payment of the termination value in satisfaction of the policy owner's contractual rights under the

Insurance, their ownership of those rights are discharged or satisfied. Similarly, where Challenger makes a payment of the sum insured in satisfaction of the nominated beneficiary's or policy owner's deceased estate's contractual rights under the Insurance, as applicable, 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) of the ITAA 1997).

90. The policy owner, their nominated beneficiary or their deceased estate, as applicable, 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 a capital loss if those capital proceeds are less than the asset's reduced cost base (subsection 104-25(3) of the ITAA 1997).

91. Section 118-300 of the ITAA 1997 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) of the ITAA 1997 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 (TD 2007/4).¹⁰

92. Item 3 of the table in subsection 118-300(1) of the ITAA 1997 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 owner of the policy (other than the trustee of a complying superannuation entity).

93. As an individual to whom the Insurance is first issued, the policy owner is regarded as an original 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) of the ITAA 1997 to disregard any capital gain or capital loss they make under section 104-25 of the ITAA 1997 from the receipt of a payment of the termination value by Challenger upon cancellation of the Insurance.

94. Item 4 of the table in subsection 118-300(1) of the ITAA 1997 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 an entity that acquired the interest in the policy for no consideration.

95. The policy owner's deceased estate or a beneficiary nominated by the policy owner to receive the sum insured in the

¹⁰ 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?*

event of the death of the policy owner, as applicable, acquires on the death of the policy owner an interest in the Insurance for no consideration. The deceased estate or the beneficiary, as applicable, will therefore be entitled under item 4 in the table in subsection 118-300(1) of the ITAA 1997 to disregard any capital gain or capital loss they make under section 104-25 of the ITAA 1997 from the receipt of a payment of the sum insured by Challenger upon the policy owner's death.

Part IVA – anti-avoidance

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

Appendix 2 – Detailed contents list

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

	Paragraph
What this Ruling is about	1
Class of entities	4
<i>Superannuation Industry (Supervision) Act 1993</i>	7
Qualifications	8
Date of effect	10
Changes in the law	12
Note to promoters and advisers	14
Ruling	15
Scheme	16
CarePlus Annuity	23
CarePlus Insurance	29
Assumptions	35
Appendix 1 – Explanation	36
CarePlus Annuity	36
<i>Subsection 27H(4) – annuity</i>	36
<i>Division 16E – qualifying security</i>	40
<i>Superannuation income stream</i>	43
<i>Division 230 – taxation of financial arrangements</i>	46
<i>Section 27H – assessability of regular payments</i>	51
<i>Capital gain or loss from regular payments under the Annuity disregarded</i>	60
CarePlus Insurance	64
<i>Premium not deductible</i>	64
<i>Payment of the sum insured not assessable as ordinary income under section 6-5</i>	67
<i>Payment of the termination value not assessable as ordinary income under section 6-5</i>	71
<i>Payments under the Insurance not assessable under section 230-15</i>	74
<i>Payments under the Insurance not assessable under section 26AH</i>	77
<i>Payments under the Insurance not assessable under section 27H</i>	82
<i>Payments under the Insurance not subject to the ‘accruals assessability’ under Division 16E of Part III</i>	84
<i>Capital gain or loss from payments under the Insurance disregarded</i>	88
Part IVA – anti-avoidance	96
Appendix 2 – Detailed contents list	97

References*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*IT 2157; IT 2346; IT 2480;
TD 2007/4; TR 2013/5*Legislative references:*

- ITAA 1936
- ITAA 1936 6
- ITAA 1936 26AH
- ITAA 1936 26AH(6)
- ITAA 1936 26AH(7)(a)
- ITAA 1936 27H
- ITAA 1936 27H(1)
- ITAA 1936 27H(1)(a)
- ITAA 1936 27H(2)
- ITAA 1936 27H(3)
- ITAA 1936 27H(3A)
- ITAA 1936 27H(4)
- ITAA 1936 51(1)
- ITAA 1936 95(2)
- ITAA 1936 Pt III Div 16E
- ITAA 1936 159GP(1)
- ITAA 1936 159GQ
- ITAA 1936 Pt IVA
- ITAA 1997
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 Div 54
- ITAA 1997 104-25
- ITAA 1997 104-25(1)(b)
- ITAA 1997 104-25(3)
- ITAA 1997 108-5(1)
- ITAA 1997 118-300
- ITAA 1997 118-300(1)
- ITAA 1997 Div 230
- ITAA 1997 230-15
- ITAA 1997 230-15(1)
- ITAA 1997 230-20(4)
- ITAA 1997 230-45(1)
- ITAA 1997 230-45(2)
- ITAA 1997 Subdiv 230-H
- ITAA 1997 230-460
- ITAA 1997 230-460(1)
- ITAA 1997 230-460(5)
- ITAA 1997 306-10
- ITAA 1997 307-70(2)
- ITAA 1997 995-1(1)
- ITAR 1997
- ITAR 1997 995-1.01
- ITAR 1997 995-1.01(1)
- IT(TP)A 1997
- SISA 1993
- SISR 1994 1.05(1)
- TAA 1953
- Life Insurance Act 1995
- Life Insurance Act 1995 9(1)(a)
- Life Insurance Act 1995 9(1)(c)
- ITA(1936)R 2015
- ITA(1936A)R 2015 7

Case references:

- Federal Commissioner of Taxation v. DP Smith (1981) 147 CLR 578; 81 ATC 4114; (1981) 11 ATR 538
- Federal Commissioner of Taxation v. Slaven (1984) 1 FCR 11; 84 ATC 4077; (1984) 15 ATR 242
- Tinkler v. Federal Commissioner of Taxation (1979) 29 ALR 663; 79 ATC 4641; (1979) 10 ATR 411

Other references:

- Prudential Standard LPS 001

ATO references

NO: 1-751NNA8
 ISSN: 2205-6114
 ATOLaw topic: Income tax ~~ Project financing ~~ Finance

© AUSTRALIAN TAXATION OFFICE FOR THE COMMONWEALTH OF AUSTRALIA

You are free to copy, adapt, modify, transmit and distribute this material as you wish (but not in any way that suggests the ATO or the Commonwealth endorses you or any of your services or products).