

# ***PR 2020/13 - Income tax: Challenger Guaranteed Annuity (Floating Rate Fixed Term)***

 This cover sheet is provided for information only. It does not form part of *PR 2020/13 - Income tax: Challenger Guaranteed Annuity (Floating Rate Fixed Term)*

 This document has changed over time. This is a consolidated version of the ruling which was published on *13 April 2022*



## Product Ruling

# Income tax: Challenger Guaranteed Annuity (Floating Rate Fixed Term)

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### **❗ Relying on this Ruling**

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

If this Ruling applies to you, and you correctly rely on it, we will apply the law to you in the way set out in this Ruling. That is, you will not pay any more tax or penalties or interest in respect of the matters covered by this Ruling.

*[Note: This is a consolidated version of this document. Refer to the Legal Database ([www.ato.gov.au/Law](http://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 which takes part in the scheme to which this Ruling relates. All legislative references in this Product 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 Guaranteed Annuity (Floating Rate Fixed Term) (the Annuity) issued by Challenger Life Company Limited (Challenger) and offered under a Product Disclosure Statement (PDS) dated 3 December 2020.

3. This Product Ruling does not address:

- the taxation consequences for an Annuity purchased by an entity other than an individual, or two individuals jointly
- the taxation consequences of acquiring, holding and redeeming the Annuity, other than as per paragraphs 15 to 31 of this Product Ruling
- 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)
- 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)
- the deductibility of the amount invested to purchase the Annuity<sup>1</sup>
- the taxation consequences of borrowing funds to purchase the Annuity, including the deductibility of interest on funds borrowed
- whether the regular payments made by Challenger under the Annuity are subject to pay as you go withholding
- the calculation of the deductible amount ascertained in accordance with subsection 27H(2) where the residual capital value in relation to the Annuity is impacted because of a partial withdrawal of the Annuity
- the taxation consequences upon repayment of the initial investment amount at the conclusion of the term of the Annuity
- the taxation consequences of rolling over the residual capital into another Annuity for a further term

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<sup>1</sup> For the purposes of this Product Ruling, it is assumed at paragraph 31(d) that no portion of the amount invested to purchase the Annuity is deductible.

- the deductibility of adviser service fees
- the treatment of any duties, taxes or other government charges that may be deducted from the regular payments or withdrawal value payable by Challenger under the Annuity, and
- a policy owner's eligibility to claim the seniors and pensioners tax offset.

### **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 that 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 trustee of a trust estate) who purchases the Annuity described in paragraphs 15 to 31 of this Product Ruling on or after 16 December 2020 and on or before 30 June 2023.
- (b) Each of two individual policy owners (other than in the capacity of trustee of a trust estate), referred to as a joint policy owner for the purposes of this Product Ruling, who jointly purchase the Annuity described in paragraphs 15 to 31 of this Product Ruling on or after 16 December 2020 and on or before 30 June 2023.
- (c) An individual (other than in the capacity of a trustee of a trust estate) nominated as a reversionary beneficiary of a policy owner referred to in paragraph 5(a) of this Product Ruling or of a surviving joint policy owner referred to in paragraph 5(b) of this Product Ruling.
- (d) The trustee of the deceased estate of a policy owner referred to in paragraph 5(a) of this Product Ruling or of a surviving joint policy owner referred to in paragraph 5(b) of this Product Ruling.
- (e) Two or more nominated beneficiaries of a policy owner referred to in paragraph 5(a) of this Product Ruling or of a surviving joint policy owner referred to in paragraph 5(b) of this Product Ruling.
- (f) An individual or the trustee of a deceased estate otherwise in receipt of regular payments made by Challenger in relation to an Annuity purchased by a policy owner referred to in paragraphs 5(a) or (b) of this Product Ruling.

- (g) Two or more nominated beneficiaries otherwise in receipt of a withdrawal value (as a death benefit) payable by Challenger in relation to an Annuity purchased by a policy owner referred to in paragraphs 5(a) or (b) of this Product Ruling.

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

- are not Australian residents for taxation purposes
- purchase the Annuity before 16 December 2020 or after 30 June 2023
- purchase the Annuity and are neither an individual policy owner nor an individual joint policy owner
- 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, or
- are not at least one of the entities listed in paragraph 5 of this Product Ruling.

## Qualifications

7. 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 15 to 31 of this Product Ruling.

8. 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
- may be withdrawn or modified.

## Date of effect

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9. This Product Ruling applies prospectively from 16 December 2020. It applies only to the specified class of entities that enter into the scheme from 16 December 2020 until 30 June 2023, 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.

10. 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**

11. 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.

12. 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**

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

## **Ruling**

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14. Subject to paragraph 3 of the Product Ruling and the assumptions in paragraph 31 of this Product Ruling:

- (a) An Annuity purchased by a policy owner referred to in paragraphs 5(a) or (b) of this Product Ruling is
  - (i) not a 'qualifying security' as defined in subsection 159GP(1)
  - (ii) not a 'superannuation income stream' as defined in regulation 995-1.01 of the *Income Tax Assessment Regulations 1997* (ITAR)<sup>1A</sup>, and
  - (iii) an 'annuity' as defined in subsection 27H(4).
- (b) An Annuity purchased by a policy owner referred to in paragraphs 5(a) or (b) of this Product Ruling is not a

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<sup>1A</sup> On 1 April 2021, the ITAR was repealed and the *Income Tax Assessment (1997 Act) Regulations 2021* (ITAR (1997 Act) 2021) commenced. From 1 April 2021, the term 'superannuation income stream' is defined in section 307-70.02 of the ITAR (1997 Act) 2021, and all references to regulation 995-1.01 and subregulation 995-1.01(1) of the ITAR in this Product Ruling should be read to mean section 307-70.02 and subsection 307-70.02(1) of the ITAR (1997 Act) 2021 respectively.

financial arrangement to which Division 230 of the ITAA 1997 applies.

- (c) The regular payments made by Challenger to an entity referred to in paragraphs 5(a), (b), (c), (d) or (f) of this Product Ruling, as applicable, 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 an entity referred to in paragraphs 5(a), (b), (c), (d) or (f) of this Product Ruling, as applicable, is ascertained (subject to subsection 27H(3)) in accordance with the formula set out in subsection 27H(2) and, but for any partial withdrawal of the Annuity, will be nil on the basis that the
  - (i) 'relevant share' in relation to the Annuity is 1 (other than for joint policy owners, in which case it is their respective ownership proportion)
  - (ii) 'undeducted purchase price' of the Annuity is the initial investment amount paid to purchase the Annuity
  - (iii) 'residual capital value' in relation to the Annuity is the purchase price of the Annuity (the initial investment amount), and
  - (iv) 'relevant number' in relation to the Annuity is the term of the Annuity (ranging from 1 to 50 years).
- (e) Any capital gain made by an entity referred to in paragraphs 5(a), (b), (c), (d) or (f) of this Product Ruling, as applicable, 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.
- (f) Any capital gain made by an entity referred to in paragraphs 5(a), (b), (c), (d) or (f) of this Product Ruling, as applicable, resulting from the payment of the withdrawal value by Challenger to them upon commutation is disregarded under section 118-300 of the ITAA 1997. The payment of the withdrawal value in these circumstances is, however, included in the assessable income of such entities, as applicable, to the extent that it exceeds a capital component calculated as the undeducted purchase price (as per paragraph 14(d)(ii) of this Product Ruling) less any deductible amounts previously applied to the regular

- payments from the Annuity, but not reduced to less than nil.
- (g) Any capital gain made by entities referred to in paragraphs 5(e) or (g) of this Product Ruling, as applicable, resulting from the payment of the withdrawal value by Challenger to them upon death is disregarded under section 118-300 of the ITAA 1997. The payment of the withdrawal value in these circumstances is, however, included in the assessable income of such entities, as applicable, to the extent that it exceeds a capital component calculated as the undeducted purchase price (as per paragraph 14(d)(ii) of this Product Ruling) less any deductible amounts previously applied to the regular payments from the Annuity, but not reduced to less than nil.
- (h) 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 class of entities referred to in paragraph 5 of this Ruling.

## Scheme

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15. 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 28 September 2020, 27 November 2020 and 7 December 2020
- Challenger Guaranteed Annuity (Floating Rate Fixed Term) PDS dated 3 December 2020, and
- draft Investor Certificate received on 28 September 2020.

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

16. For the purposes of describing the scheme to which this Product Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which an entity referred to in paragraph 5 of this Product Ruling, or any associate of such entity, will be a party to, which are a part of the scheme.

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

## Overview

18. The Annuity satisfies the definition of a 'life insurance policy' under subsection 995-1(1) of the ITAA 1997 and is offered by Challenger in Australia to individuals over 18 years of age, companies and trusts (including self-managed superannuation funds). Individuals who purchase the Annuity can do so alone or jointly with another person.

19. To purchase the Annuity, policy owners are required to execute and lodge the application form attached to the PDS with Challenger, together with an initial investment amount of at least \$10,000 which cannot be funded using a roll-over superannuation benefit. No additional fees or charges are payable to Challenger by a policy owner, and no further capital can be added to the initial investment amount once the Annuity has commenced.

20. Upon acceptance of a valid application, a policy owner is issued with the Policy Document (a legal contract between a policy owner and Challenger) and an Investor Certificate by Challenger, setting out the relevant terms and conditions.

21. In exchange for the initial investment amount, the Annuity provides regular payments (monthly, quarterly, half-yearly or yearly<sup>2</sup>) for a term of one-to-50 years, as chosen by the policy owner and subject to an event which causes the Annuity to end sooner. Regular payments made to joint policy owners are split in whatever proportion they nominate at the time the Annuity is purchased, or otherwise in equal proportions.

22. The amount of the regular payments payable by Challenger depends on a number of factors, including:

- the amount of the initial investment
- prevailing investment market conditions
- the term of the Annuity, and
- any choice to partially withdrawal the Annuity early,

and will be adjusted in line with changes in the Reserve Bank of Australia (RBA) cash rate over the regular payment period chosen by the policy owner.

23. Where individuals purchase the Annuity jointly with another person and one of the joint policy owners dies during the term of the Annuity, the deceased joint policy owner's regular payments will be made to the surviving joint policy owner.

24. At the time the Annuity is purchased, an individual policy owner can nominate one or more beneficiaries in the event they die before the term of the Annuity ends. A reversionary beneficiary entitled to receive regular payments under the circumstances

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<sup>2</sup> Yearly payments cannot be chosen where the term for the Annuity is one year.

contemplated in paragraph 26 of this Product Ruling can, at the time that entitlement arises, nominate one or more beneficiaries of their own in the event they die before the term of the Annuity ends. Beneficiaries can only be nominated under an Annuity purchased jointly by individuals by the surviving joint policy owner where the other joint policy owner dies during the term of the Annuity.

25. Where an individual policy owner (including any surviving joint policy owner) or a reversionary beneficiary, as applicable, does not nominate a beneficiary and dies during the term of the Annuity, the regular payments will continue to be made to their estate.

26. Where an individual policy owner (including any surviving joint policy owner) or a reversionary beneficiary, as applicable, nominates a single beneficiary (as their reversionary beneficiary) and dies during the term of the Annuity, the regular payments will continue to be made to their reversionary beneficiary.

27. Where an individual policy owner (including any surviving joint policy owner) or a reversionary beneficiary, as applicable, nominates multiple beneficiaries and dies during the term of the Annuity, the beneficiaries will be paid a withdrawal value as a lump sum death benefit in the proportions specified by the deceased, or otherwise in equal proportions, and the Annuity will end. Where a beneficiary predeceases the policy owner or reversionary beneficiary, as applicable, their proportion of the withdrawal value will be paid pro rata to the remaining beneficiaries. If all beneficiaries predecease the policy owner or reversionary beneficiary, as applicable, the withdrawal value will be paid to the estate of that policy owner or reversionary beneficiary.

28. The Annuity can be withdrawn in part or full prior to the end of its term by the policy owner (or by any other applicable entity receiving the regular payments at the time in accordance with paragraphs 25 and 26 of this Product Ruling). The applicable entity in receipt of the regular payments at the time will be paid a withdrawal value. The regular payments (and the Annuity) will end where the Annuity is withdrawn in full.

29. The amount of the withdrawal value paid under the circumstances contemplated by paragraphs 27 and 28 of this Product Ruling will be at least the present value of the future regular payments due for the remainder of the term of the Annuity and no less than the amount prescribed by the *Life Insurance Act 1995*.

30. Subject to any earlier partial withdrawals of the Annuity (which will likely reduce the residual capital value of the Annuity) and/or any decision at the end of the term of the Annuity to roll over the residual capital into another Annuity for a further term, at the conclusion of the term the initial investment amount is repaid to the policy owner (or to any other applicable entity receiving the regular payments at the time in accordance with paragraphs 25 and 26 of this Product Ruling), and the Annuity ends.

## Assumptions

31. This Product Ruling is made on the basis of the following assumptions:
- (a) Each of the entities referred to in paragraph 5 of this Product Ruling are
    - (i) individual Australian residents for taxation purposes and are not taxation residents of a country with which Australia has concluded a double-tax treaty, or
    - (ii) Australian resident trust estates as defined in subsection 95(2) and are not resident trust estates of a country with which Australia has concluded a double-tax treaty.
  - (b) A policy owner referred to in paragraphs 5(a) or (b) of this Product Ruling 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.
  - (c) Each policy owner is the original policy owner who purchased the Annuity from Challenger for their own benefit.
  - (d) No portion of the amount invested to purchase the Annuity is deductible.
  - (e) All dealings between any of the entities referred to in paragraph 5 of this Product Ruling and Challenger will be at arm's length.
  - (f) 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 15 of this Ruling.

## Appendix 1 – Explanation

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

### Subsection 27H(4) – annuity

32. 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*).

33. This definition encompasses an annuity on ordinary concepts, as contemplated within various judicial authorities and discussed in Taxation Ruling IT 2480 *Income tax: variable annuities*. An annuity on ordinary concepts is a contract under which a principal sum is converted into an income stream<sup>3</sup> 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.

34. A policy owner’s initial 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), variable in a way calculated by reference to RBA cash rate movements, and (unless commuted in full earlier for the withdrawal value) continue for a fixed term. The ability of the policy owner (or of any other applicable entity receiving the regular payments at the time) to commute does not of itself result in the Annuity failing to be accepted as an annuity contract (see paragraph 25 of IT 2480).

35. An Annuity purchased by a policy owner referred to in paragraphs 5(a) or (b) of this Product Ruling therefore constitutes an annuity on ordinary concepts and, subject to the exclusions in paragraphs (a) and (b) of the definition (considered at paragraphs 36 to 40 of this Product Ruling), constitutes an annuity as defined in subsection 27H(4).

<sup>3</sup> The term ‘income stream’ is defined at paragraph 5 of Taxation Ruling TR 2013/5 *Income tax: when a superannuation income stream commences and ceases* 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***

36. An annuity is excluded from the definition of a ‘qualifying security’ in subsection 159GP(1) unless it is an annuity to which subsection 159GP(10) applies. An annuity will be one to which subsection 159GP(10) applies where, among other requirements, the annuity is not 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’.

37. An Annuity issued by Challenger to a policy owner referred to in paragraphs 5(a) or (b) of this Product Ruling (that is, a natural person other than in the capacity of trustee of a trust estate) is an ineligible annuity. Therefore, the Annuity is not one to which subsection 159GP(10) applies and, as such, is not a qualifying security for the purposes of Division 16E.

## ***Superannuation income stream***

38. 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 *Superannuation Industry (Supervision) Act 1993* (SISA) in accordance with subregulation 1.05(1) of the *Superannuation Industry (Supervision) Regulations 1994* (SISR).

39. 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.

40. As per paragraph 19 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 31(b) of this Product Ruling, it is assumed for the purposes of this Product Ruling that a policy owner referred to in paragraphs 5(a) or (b) of this Product Ruling 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***

41. 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 settleable' 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.

42. The Annuity constitutes a financial arrangement for the purposes of Division 230 of the ITAA 1997 on the basis that the entities referred to in paragraph 5 of this Product Ruling have cash-settleable rights to receive a financial benefit in the form of the regular payments and/or the withdrawal value, as applicable, and on the basis that a policy owner has a cash-settleable obligation to provide a financial benefit in the form of the initial investment amount.

43. 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 income tax acts (subsection 230-20(4) of the ITAA 1997), including section 27H.

44. 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.

45. As the Annuity is a life insurance policy as defined in subsection 995-1(1) of the ITAA 1997 (as per paragraph 18 of this Product Ruling) that is not a qualifying security (as defined in subsection 159GP(1) and discussed at paragraphs 36 to 37 of this Product Ruling), the exception in subsection 230-460(5) applies and Division 230 of the ITAA 1997 does not apply to any gains or losses derived from an Annuity purchased by a policy owner referred to in paragraphs 5(a) or (b) of this Ruling.

### ***Section 27H – assessability of regular payments***

46. 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 an entity referred to in paragraphs 5(a), (b), (c), (d) or (f) of this Product Ruling, as applicable, are therefore assessable income under subsection 27H(1) to the extent that the regular payments exceed the deductible amount in relation to the Annuity.

47. 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.

48. In accordance with the definition of the term in subsection 27H(4), the 'relevant share' in relation to the Annuity (component A) for an entity referred to in paragraphs 5(a), (c), (d) or (f) of this Product Ruling is 1. The relevant share in relation to the Annuity for a policy owner referred to in paragraph 5(b) of this Product Ruling is a fraction corresponding with their respective share in the Annuity.

49. The undeducted purchase price in relation to an Annuity (component B) that is purchased by a policy owner referred to in paragraphs 5(a) or (b) of this Product Ruling is the whole of the purchase price of the Annuity (the initial investment amount), reduced by any portion of the initial investment amount that is an allowable deduction. As per paragraph 31(d) of this Product Ruling, it is assumed for the purposes of this Ruling that no portion of the initial investment amount is deductible.

50. The residual capital value in relation to an annuity is defined in subsection 27H(4) as 'the capital amount payable on the termination of the annuity'. Subject to any earlier partial withdrawal, the terms of the Annuity provide that the residual capital value in relation to the Annuity (component C) is the value of the purchase price.

51. Where an annuity is payable for a term of years certain, the relevant number in relation to that annuity in relation to a year of income is defined in subsection 27H(4) to mean the number of years in the term. The relevant number in relation to the Annuity (component D) is therefore the number of years in the term of the Annuity, as chosen by the policy owner.

52. Subject to any earlier partial withdrawal of the Annuity, the deductible amount ascertained in accordance with the formula under subsection 27H(2) will be nil and the whole of the regular payments received by an entity referred to in paragraphs 5(a), (b), (c), (d) or (f) of this Product Ruling, as applicable, should be included in their assessable income pursuant to subsection 27H(1).

#### ***Assessability of withdrawal value***

53. The receipt of the withdrawal value from Challenger by:

- an entity referred to in paragraphs 5(a), (b), (c), (d) or (f) of this Product Ruling upon commutation of the Annuity, or
- an entity referred to in paragraphs 5(e) or (g) of this Product Ruling on the death of the relevant entity entitled to receive regular payments under the Annuity,

as applicable, is assessable income to the extent that it does not comprise a repayment of capital. The capital component of the withdrawal value in these circumstances is the undeducted purchase price of the Annuity less any deductible amounts previously applied to the regular payments from the Annuity, but not reduced to less than nil.

54. Any amount referred to in paragraph 53 of this Product Ruling which is included in the assessable income of a trustee of a deceased estate shall be deemed to be income to which no beneficiary is presently entitled pursuant to subsection 101A(1).

#### ***Capital gain or loss from payments under the Annuity disregarded***

55. Under subsection 108-5(1) of the ITAA 1997 a capital gains tax (CGT) asset is any kind of property or a legal or equitable right that is not property. The contractual rights of the entities referred to in paragraph 5 of this Product Ruling 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 give rise to a CGT event C2 (paragraph 104-25(1)(b) of the ITAA 1997).

56. 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).

### *Section 118-300 – regular payments*

57. Table item 3 of 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 or an annuity instrument is disregarded where that CGT event happens to the original owner of the policy or instrument (other than the trustee of a complying superannuation entity). Where two or more persons jointly affect a policy of life assurance or an annuity instrument, each person may be an original owner.

58. As an individual to whom the Annuity is first issued, a policy owner referred to in paragraphs 5(a) or (b) of this Product Ruling is regarded as an original owner of an annuity instrument. Pursuant to table item 3 of subsection 118-300(1) of the ITAA 1997, any capital gain or capital loss a 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.

59. Table item 4 of 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 or an annuity instrument is disregarded where that CGT event happens to an entity that acquired the interest in the policy or instrument for no consideration.

60. An entity referred to in paragraphs 5(c), (d) or (f) of this Product Ruling is an entity that acquires, on the death of a policy owner or reversionary beneficiary, as applicable, an interest in the Annuity for no consideration. Pursuant to table item 4 of subsection 118-300(1) of the ITAA 1997, any capital gain or capital loss such an entity makes under section 104-25 of the ITAA 1997 from the receipt of regular payments by Challenger under the Annuity is therefore disregarded.

### *Section 118-300 – payment of withdrawal value*

61. As a policy owner referred to in paragraphs 5(a) or (b) of this Product Ruling is regarded as an original owner of an annuity instrument, pursuant to table item 3 of subsection 118-300(1) of the ITAA 1997 they will disregard any capital gain or capital loss they

make under section 104-25 of the ITAA 1997 from the receipt of the withdrawal value from Challenger upon commutation of the Annuity.

62. An entity referred to in paragraphs 5(c), (d) or (f) of this Product Ruling acquires, on the death of a policy owner or reversionary beneficiary, as applicable, an interest in the Annuity for no consideration and will therefore, pursuant to table item 4 of subsection 118-300(1) of the ITAA 1997, disregard any capital gain or capital loss they make under section 104-25 of the ITAA 1997 from the receipt of the withdrawal value from Challenger upon commutation of the Annuity.

63. An entity referred to in paragraphs 5(e) or (g) of this Product Ruling acquires, on the death of a policy owner or reversionary beneficiary, as applicable, an interest in the Annuity for no consideration and will therefore, pursuant to table item 4 of subsection 118-300(1) of the ITAA 1997, disregard any capital gain or capital loss they make under section 104-25 of the ITAA 1997 from the receipt of the withdrawal value from Challenger upon the relevant death.

#### **Part IVA – anti-avoidance**

64. Provided that the scheme ruled on is entered into and carried out as disclosed in this Product Ruling, Part IVA will not apply.

## **Appendix 2 – Detailed contents list**

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

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