TD 95/26W - Income tax: can the value of an annuity contract be amortised over the effective life of the annuity and the amortisation expense deducted from the annuity income when calculating the separate net income of a dependant under section 159J of the Income Tax Assessment Act 1936 ?

Taxation Determination

Income tax: can the value of an annuity contract be amortised over the effective life of the annuity and the amortisation expense deducted from the annuity income when calculating the separate net income of a dependant under section 159J of the *Income Tax Assessment Act 1936*?

1. Yes. Separate net income is calculated as the dependant's gross income less any expenses incurred in earning such income. Expenses which are considered to be a direct charge against the income can be deducted from the dependant's gross income to determine the separate net income. When deciding if an expense is a direct charge against income a taxpayer may look at the ordinary accounting and commercial principles that apply.

2. When a taxpayer purchases an annuity, the principal used to purchase the annuity ceases to exist as it has been transformed into an income source. Annuity payments are not derived from the money paid for the annuity; they are derived solely from the annuity contract. The annuity contract creates an asset, that is, the right to receive the annuity. That asset is a non-current asset.

3. It is normal accounting practice to amortise or depreciate a non-current asset over its expected life. Therefore, the value of an annuity contract may be amortised over the expected life of the annuity. The amortisation expense can be deducted from annuity income to reflect the true net profit from the annuity when calculating separate net income. The value of the annuity contract is the amount paid to purchase the annuity.

4. The Commissioner will accept a straight line method of amortisation over the expected life of the annuity consistent with the method used under section 27H to ascertain the deductible amount to be excluded annually for income tax assessment purposes. The amortisation period will be the 'relevant number' as defined in section 27H. The 'relevant number' is the annuity term where the annuity is paid for a fixed term or the life expectation of the annuitant where the annuity is paid during the annuitant's lifetime.

Example

On 1 July 1993, Jane who is 65 years old purchases an annuity of $1,100 per annum for life at a cost of $10,000. In calculating Jane's separate net income, Jane amortises the value of the annuity *contract on a straight line basis over her expected life of 18.56 years using the Australian Life Tables 1985-87. Jane can reduce the amount of annuity income by $538 (i.e., $10,000 ÷ 18.56). For separate net income purposes, Jane's annuity income will be $562 (i.e., $1100 - 538).*

Commissioner of Taxation
22/6/95

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