



CHARTERED ACCOUNTANTS
AUSTRALIA + NEW ZEALAND

DavidCo Limited
CHARTERED ACCOUNTANTS

Level 2, Shortland Chambers
70 Shortland Street, Auckland
PO Box 2380, Shortland Street
Auckland 1140
T +64 9 921 6885
F +64 9 921 6889
M +64 21 639 710
E arun.david@davidco.co.nz
W www.davidco.co.nz

WEEKLY COMMENT: FRIDAY 14 AUGUST 2015

1. This week I continue looking at employee remuneration in the form of fringe benefits and expenditure on account of an employee and I review four recent items:
 - (a) QB 15/05 *Income Tax – Insurance - Term life insurance policy taken out by employee with employer paying the premium on employee’s behalf* (published in *Tax Information Bulletin* Vol. 27 No. 6, July 2015, pages 13-14);
 - (b) QB 15/06: *Income Tax-Insurance-Term life insurance policy taken out by employer for the benefit of an employee* (also published in *Tax Information Bulletin* Vol. 27 No. 6, July 2015, pages 15-18);
 - (c) Draft QWBA PUB00215-3: *Insurance — personal sickness and accident insurance taken out by employee with employer paying the premiums on employee’s behalf* (released on 6 August with a deadline for comment of 17 September); and
 - (d) Draft QWBA PUB00215-4: *Income tax — insurance — personal sickness and accident insurance taken out by employer for the benefit of an employee* (also released on 6 August with a deadline for comment of 17 September).
2. All four items arose out of Inland Revenue’s recent review of Public Information Bulletins.

QB 15/05: Employee’s term life insurance premium paid by employer

3. The question in QB 15/05 concerns the income tax treatment of a term life insurance policy taken out by the employee (i.e. the employee is the policy holder), but the employer pays the premiums on the employee’s behalf. The answers are as follows.
4. The payment of the premiums by the employer does not give rise to a fringe benefit. It is expenditure on account of an employee and is subject to PAYE tax deductions because:
 - (a) The employee has a legal obligation to the insurance company to pay the insurance premiums and personally incurs the expenditure; and
 - (b) Under s. CE 5(1), “expenditure on account of an employee” means a payment made by an employer relating to expenditure incurred by an employee (or to be incurred by an employee), therefore the premiums fall under the definition; and
 - (c) A payment of expenditure on account of an employee is part of the employee’s “salary or wages” under s. RD 5(2) to which the PAYE rules apply under s. RD 3.

5. The employer is allowed a tax deduction for the premiums paid because the premiums constitute salary and wage costs, which are deductible because they satisfy the general permission in s DA 1 and none of the general limitations will apply.
6. The employee privately owns the term life insurance policy and a lump sum paid out under the policy will not be taxable income of the employee because:
 - (a) There are no specific provisions in Part C of the *Income Tax Act 2007* that tax payments under term life policies; and
 - (b) A lump sum payment under a life insurance policy is not income under ordinary concepts under s. CA 1(2).

QB 15/06: Term life insurance taken out by an employer for the benefit of an employee

7. The question in QB 15/06 concerns the income tax treatment of a term life insurance policy that is taken out by an employer for the benefit of an employee (or their spouse, civil union partner, de facto partner or child). The answers are as follows.
8. The premiums paid by the employer will be subject to fringe benefit tax (“FBT”) because:
 - (a) Under s. CE 5(2) “expenditure on account of an employee” includes a premium that an employer pays on a life insurance policy taken out for the benefit of the employee, or their spouse, civil union partner, de facto partner, or their child;
 - (b) However, under s. CE 5(3)(f), “expenditure on account of an employee” does not include a premium that an employer pays on a life insurance policy taken out for the benefit of the employee, or their spouse, civil union partner, de facto partner, or their child, if:
 - (i) The premium cannot be refunded to, or converted to cash by, the employee or an associated person; and
 - (ii) The only benefits that are payable under the policy are those payable on the death of the employee, or their spouse, civil union partner, de facto partner, or their child, or those payable because of accident, disease, or sickness of the employee, or their spouse, civil union partner, de facto partner, or their child; and
 - (iii) A term life policy taken out by an employer will meet the requirements of s. CE 5(3)(f) and be excluded from being expenditure on account of an employee; and
 - (c) Premiums paid by an employer on a term life policy taken out by the employer will be fringe benefits subject to FBT under s. CX 2, and an unclassified benefit under s CX 37, as opposed to a “specified insurance premium” under s. CX 16, because a “specified insurance premium” is one that is paid on a policy of insurance on the life of an employee or family member singly or jointly which meets the following requirements:
 - (i) For policies other than whole of life policies, the minimum term is 10 years, or 5 years for a policy which matures no earlier than when the life assured reaches 60 years; and
 - (ii) The only benefits payable within the first 10 years or before the policy’s maturity date if earlier are benefits payable upon death, or additional benefits payable for an accident, disease or sickness; and
 - (iii) The policy provides for a payment upon death that is not a return of premiums, is substantially capital, and is not materially less than the total benefit payable under the policy otherwise than for death, or is a life assurance policy for a person who, because

of disability or ill health, is unable to take out a policy that results in such a payment upon death, or is a deferred life assurance policy on the life of a child;

(iv) In the Commissioner's view, s. CX 16(4) applies to policies that have a savings component (which term life policies do not), therefore, term life insurance policies will not satisfy s CX 16, and premiums paid will be unclassified benefits under s CX 37; and

(d) If the premiums are paid on the life of a person other than the employee, such as a family member, s. GB 32 treats the benefit as if it were provided by the employer to the employee (subject to the shareholder-employee exemption in s GB 32(2) and the look-through company exemption in s GB 32(2B)), therefore, such premiums will also be subject to FBT.

9. The payment of a life insurance premium for the benefit of an employee (or their family) is a business cost just like the employee's salary or wages. Therefore, provided the costs of an employee's salary or wages are deductible, the costs of paying the insurance premiums will be tax-deductible to the employer.

Draft QWBA: Employer pays premiums on an employee's sickness and accident policy

10. This question concerns the income tax treatment of a personal sickness or accident insurance policy that is taken out by the employee (i.e. the employee is the policy holder) and the premiums are paid by the employer on the employee's behalf.

11. It is noted that some personal sickness or accident insurance policies include elements of income protection insurance which may have a different tax treatment to other personal sickness or accident insurance. In addition, the question does not concern the meaning of the phrase "calculated according to loss of earnings" in s. CW 34, under which certain payments under a policy of personal sickness or accident insurance will be exempt from tax.

12. In the circumstances of this question, the payment of the premiums by the employer does not give rise to a fringe benefit and, premiums paid for income protection insurance excepted (see paragraph 13 below), premiums paid for other personal sickness or accident insurance policies will be treated as salary or wages and, therefore, subject to PAYE for the same reasons as those set out in paragraph 4 above:

(a) The employee has a legal obligation to the insurance company to pay the insurance premiums and personally incurs the expenditure; and

(b) Under s. CE 5(1), "expenditure on account of an employee" means a payment made by an employer relating to expenditure incurred by an employee (or to be incurred by an employee), therefore the premiums fall under the definition; and

(c) A payment of expenditure on account of an employee is part of the employee's "salary or wages" under s. RD 5(2) to which the PAYE rules apply under s. RD 3.

13. Premiums for income protection insurance are an exception and are not subject to PAYE. Such premiums are covered by an exclusion in s. CE 5(3)(j) which provides that the payment of a premium will not be expenditure on account of an employee to the extent that the premium paid is:

(a) For "income protection insurance"; and

(b) The employer has a liability to pay (or make a contribution towards) that premium.

14. As far as the tax treatment of the proceeds from the policy to the employee is concerned:

(a) If the exclusion in s. CE 5(3)(j) applies to the premiums such that the proceeds are paid out under a policy of income protection insurance where the employer is liable to pay or contribute to the premiums, the proceeds will be taxable under s. CE 11 unless the exemption in s. CW 34 applies and the payment:

- (i) Is made to a person because they (or another person) are incapacitated for work; and
- (ii) Is not calculated according to loss of earnings.

(b) If the exclusion in s. CE 5(3)(j) does not apply, such that the premiums are subject to PAYE deductions, the proceeds will be taxable unless:

- (i) Where the proceeds are income under ordinary concepts and taxable under s. CA 1(2), the exemption in s. CW 34 referred to in subparagraph (a) above applies; or
- (ii) The proceeds are not income under ordinary concepts.

15. Whether or not the proceeds are income under ordinary concepts will depend on the relationship between the payer and the recipient and the purpose of the payment (*Reid v CIR* (1985) 7 NZTC 5,176):

(a) Where payments (either periodic or lump sum) are made to replace income which the recipient would otherwise have earned or where the payments become part of the receipts that the recipient may depend on for their living expenses, the payments are likely to be income.

(b) Payments that are regular or recurring are much more likely to be income (*Reid*).

(c) A one-off payment may still be income (*FCT v Hyteco Hiring Pty Ltd* 92 ATC 4,694).

(d) Other lump sum and reimbursing payments are unlikely to be income (for example, a lump sum payment made to compensate a person for the loss of a limb, or a payment reimbursing medical expenses).

(e) Where a single payment is made for more than one thing, apportionment may be required.

Draft QWBA: Sickness and accident insurance taken out by employer for employee

16. The question concerns the income tax treatment of a personal sickness or accident insurance policy that is taken out by an employer where an employee (or their spouse, civil union partner, de facto partner or child) is the beneficiary.

17. In this case, unless the exclusion in s. CX 31 for a premium for income protection insurance applies (see paragraph 18 below), the payment of the premiums will constitute the provision of fringe benefits and FBT will apply:

(a) The Commissioner's view is that the provision of an accident or sickness insurance policy where the employee is a beneficiary is a "benefit" to the employee and, if provided in connection with their employment, s. CX 2(1)(a) is satisfied and the premiums will be fringe benefits.

- (b) It is then necessary to consider whether the premium is a specified benefit or an unclassified benefit:
- (i) A contribution to a health insurance policy will be a specified insurance policy under s. CX 16(6) if the only benefits payable under the policy are for accident, disease or sickness;
 - (ii) If s. CX 16(6) does not apply, the premiums will be unclassified benefits under s. CX 37.
- (c) If the premiums are paid on the life of a person other than the employee, such as a family member, s. GB 32 treats the benefit as if it were provided by the employer to the employee (subject to the shareholder-employee exemption in s GB 32(2) and the look-through company exemption in s GB 32(2B)), therefore, such premiums will also be subject to FBT.
18. Section CX 31 provides an exclusion from FBT for a premium for income protection insurance if all the following requirements are met:
- (a) The income protection insurance is provided by the employer for the benefit of an employee; and
 - (b) The employer satisfies a liability to pay or contribute to the premiums; and
 - (c) A pay-out under the insurance policy would be assessable income of the employee (see paragraph 14 onwards above).
19. The tax treatment of the proceeds from the policy to the employee has already been discussed in paragraphs 14 and 15 above. The tax treatment of the proceeds is the same regardless of whether the employee or the employer takes out the policy.



Arun David, Director,
DavidCo Limited