

QUESTION WE'VE BEEN ASKED QB 15/10

INCOME TAX – INSURANCE – PERSONAL SICKNESS AND ACCIDENT INSURANCE TAKEN OUT BY EMPLOYER FOR THE BENEFIT OF AN EMPLOYEE

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

This Question We've Been Asked is about ss CA 1, CA 2(2), CE 1(1), CE 5, CE 11, CW 34, CX 2, CX 16, CX 31, CX 37, DA 1, DA 2 and GB 32.

1. This **Question We've Been Asked (QWBA)** considers the income tax treatment of personal sickness or accident insurance policies. Some personal sickness or accident insurance policies include elements of income protection insurance. There are specific provisions in the Act that apply only to income protection insurance, so income protection insurance may have a different tax treatment to other personal sickness or accident insurance.
2. This QWBA does not consider the treatment of payments to or from sickness, accident, or death benefits funds.
3. This QWBA also does not consider the treatment of weekly compensation purchased under s 223 of the Accident Compensation Act 2001.

Question

4. What is 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?

Answer

5. The employer will generally be entitled to a deduction for the premiums paid.
6. The premiums paid will be subject to FBT unless they are premiums paid for income protection insurance where:
 - the employer has a liability to pay (or contribute to) the premiums; and
 - a pay-out under the insurance policy would be assessable income of the employee.
7. Amounts paid out (or that an employee is otherwise entitled to) under income protection insurance policies will be **the employee's** income under s CE 11. Amounts paid out (or that an employee is otherwise entitled to) under other personal sickness or accident insurance policies will be income only if they are income under ordinary concepts (s CA 1(2)). Amounts that are not income under ordinary concepts will not be subject to tax.
8. Amounts that are income under s CE 11 or s CA 1(2) will be exempt income if they are payments:
 - made to a person because they (or another person) are incapacitated for work; and either
 - o paid by a friendly society (s CW 34(2)(a)); or
 - o not calculated according to a loss of earnings (s CW 34(2)(c)).
9. If the payment does not meet these criteria, it will be assessable income.

10. This item applies to both individual personal sickness or accident insurance policies and group policies where the employees (or associates) are the beneficiaries of the policy.

Explanation

11. Inland Revenue recently undertook a review of all Public Information Bulletins (see <http://www.ird.govt.nz/technical-tax/pib-review/>). During that review, two items on the income tax treatment of insurance in an employment context were identified as being out of date. The two items are "Staff insurance schemes" (*Public Information Bulletin* No 70 (December 1972): 11) and "Life and accident insurance policies" (*Public Information Bulletin* No 106 (July 1980): 2). Those PIBs covered a number of different scenarios. We intend to replace the PIBs with a series of Questions We've Been Asked (QWBAs) covering common scenarios.
12. This QWBA considers the situation where a personal sickness or accident insurance policy is taken out by an employer for the benefit of an employee. See QB 15/09 for discussion of situations where the employee takes out the policy and the employer pays the premiums.
13. There are many different types of insurance policies that could be sickness or accident insurance (or could include an element of personal sickness or accident insurance). These include medical insurance, income protection insurance, accident insurance, and trauma or critical illness policies. Pay-outs under these insurance policies can be periodic or lump sum and can be calculated in a variety of ways.
14. Where only part of a policy comes within a particular definition, it may be necessary to apportion premiums between different types of insurance. Similarly where a pay-out under a policy is made for more than one thing, apportionment of the receipt may be required.

Deductibility of premiums for employer

15. A person is allowed a deduction for an amount of expenditure or loss to the extent that it is incurred by them in the course of carrying on a business for the purpose of deriving assessable (and/or excluded) income (s DA 1). Section DA 2 sets out some limitations on deductibility. For example, expenditure that is capital in nature, or expenditure incurred in deriving exempt income, is not deductible (s DA 2(1) and (3)).
16. In most cases, salary and wage costs will be deductible because they will satisfy the nexus test in s DA 1 and none of the general limitations will apply. The payment of a sickness or accident insurance premium for an employee that is **paid in connection with the employee's employment** is a business cost just like **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 too.

When amount of premium is subject to FBT

17. Under s CX 2, a "fringe benefit" is a "benefit" that is provided by an employer to an employee in connection with their employment (s CX 2(1)(a)) and comes under s CX 2(1)(b) within either one of ss CX 6, CX 9, CX 10, or CX 12 to CX 16 (specified benefits) or is an unclassified benefit under s CX 37. Some benefits are also excluded from being fringe benefits by specific provisions in subpart CX (see s CX 2(1)(c)).
18. **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.** It provides an economic advantage to the employee as it gives the

employee benefits (coverage under the policy) to which they would otherwise not be entitled. Provided the benefit is provided to an employee in connection with their employment, s CX 2(1)(a) is satisfied. It is, therefore, necessary to consider whether the policy is a specified benefit under one of ss CX 6, CX 9, CX 10, or CX 12 to CX 16, or whether an unclassified benefit arises (s CX 37). It is also necessary to consider whether any exclusion could apply.

19. The only potentially relevant specific provision is s CX 16. Section CX 16 applies when an employer pays a "specified insurance premium" or makes a contribution to the insurance fund of a friendly society for the benefit of an employee (s CX 16(1)). The potentially **relevant definition of "specified insurance premium"** is set out in s CX 16(6):

CX 16 Contributions to life or health insurance

...

Health insurance

- (6) The third kind of policy referred to in subsection (3) is a policy of insurance under which the benefits are payable only for—
- (a) an accident, whether fatal or not, to the employee, their spouse, civil union partner or de facto partner, or their child; or
 - (b) disease or sickness of the employee, their spouse, civil union partner or de facto partner, or their child.
20. A sickness or accident insurance policy will come within s CX 16 where the only benefits payable under the policy are for accident, disease or sickness. If a sickness or accident insurance policy fits within s CX 16(6), then s CX 2(1)(b) will be satisfied.
21. If a sickness or accident insurance policy does not come within s CX 16, it will be an unclassified benefit under s CX 37 (as long as there is no specific provision in subpart CX excluding it). Section CX 37 applies to benefits that an employer provides to an employee in connection with their employment that are not covered and are not excluded by a more specific provision.
22. Where an employer provides a fringe benefit to a person associated with an employee, s GB 32 may treat the benefit as if it were provided by the employer to the employee. This is subject to the shareholder-employee exemption in s GB 32(2) and the look-through company exemption in s GB 32(2B). Therefore, premiums paid on policies of personal sickness and accident insurance taken out **by an employer for the benefit of an employee's spouse, civil union partner, de facto partner or child** will also be subject to FBT.

Exclusion from FBT

23. The only potentially relevant exclusion is s CX 31. Section CX 31 provides:
- An employer who satisfies a liability to pay, or contribute to the payment of, a premium for income protection insurance for the benefit of an employee does not provide a fringe benefit to the employee if a payment of the insurance to the employee would be assessable income of the employee.
24. Section CX 31 will exclude from FBT such income protection insurance:
- provided by an employer;
 - for the benefit of an employee;
 - where the employer satisfies a liability to pay (or contribute to) the premiums; and
 - a pay-out under the insurance policy would be assessable income of the employee (this requirement is considered below).

25. Where a personal sickness or accident policy is also (or also includes) income protection insurance and all of the above requirements are met, the provision of the income protection insurance will not be a fringe benefit. In all other cases, FBT will apply.

Treatment of proceeds to the employee

26. Whether a payment made under an insurance policy is taxable will depend on what it is paid for. Some payments will not be income (under a specific provision or ordinary concepts) and, therefore, will not be taxable. Payments that are **"income"** may be either assessable or exempt income depending on the circumstances. The following discussion is intended to assist with determining how a payment under an insurance policy should be treated.

Is the payment to the employee income?

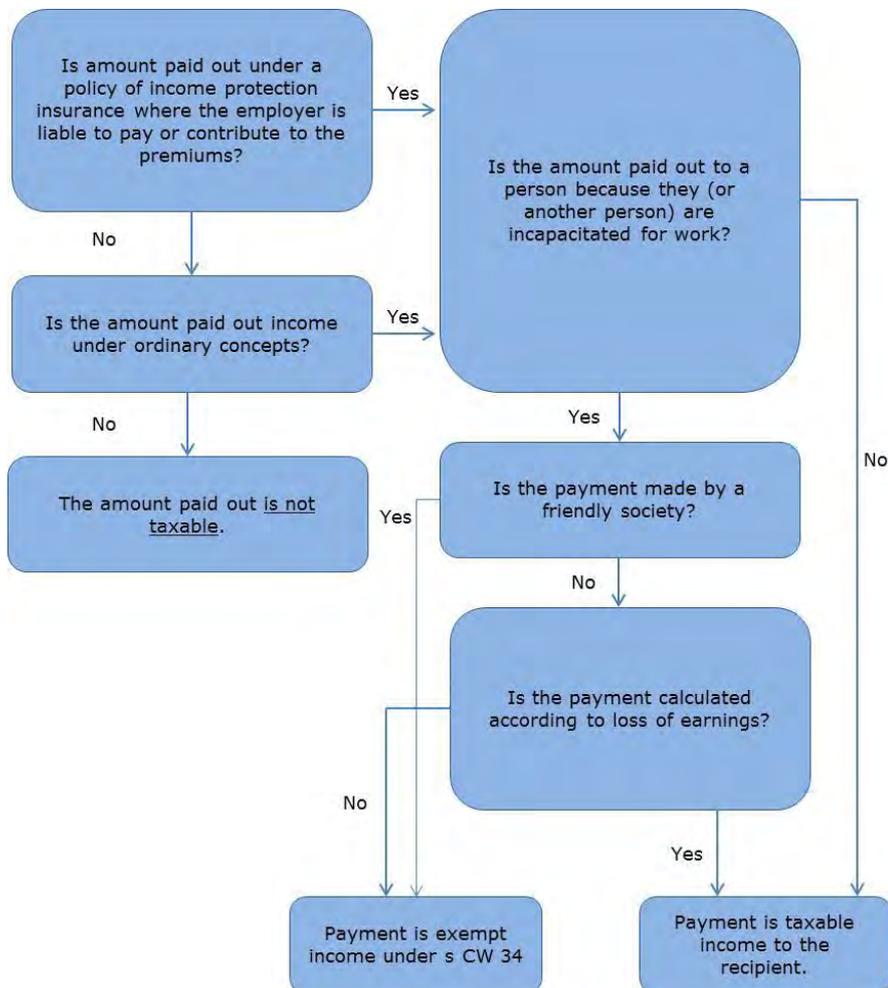
27. If a personal sickness or accident insurance policy is (or includes) income protection insurance, s CE 11 may apply. Payments made under a policy of income protection insurance where an employer is liable to pay or contribute to the premiums are income to the employee under s CE 11.
28. There are no specific provisions that apply to make payments under other personal sickness or accident insurance policies income. Therefore, payments under these policies will be income only if they are income under ordinary concepts (s CA 1(2)).
29. Whether a payment under an insurance policy is income or not 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). Where a payment is made to replace income which the recipient would otherwise have earned or where the purpose of the payments is to provide the recipient with amounts to meet their living expenses, the payments are likely to be income. Payments that are regular or recurring are much more likely to be income (*Reid*). However, a one-off payment may still be income (*FCT v Hyteco Hiring Pty Ltd* 92 ATC 4,694).
30. Therefore, the payments that are most likely to be income are payments that are intended to compensate an insured person for lost income (whether periodic, or lump sum) and other regular or periodic payments intended to help the insured person meet their living expenses. Other lump sum and reimbursing payments are unlikely to be income (for example, a lump sum payment made for the loss of a limb, or a payment reimbursing medical expenses).
31. **Payments that are not "income" (either under s CE 11 or s CA 1(2)) will not be taxable. If a payment is "income", it is necessary to consider whether it is assessable income or exempt income.**

Is the payment exempt income of the employee?

32. The relevant exemption provision is s CW 34. A payment of income made under a policy of personal sickness or accident insurance will be exempt under s CW 34 if:
- It is made to a person because they (or another person) are incapacitated for work; and either
 - the payment is made by a friendly society; or
 - the payment is not calculated according to a loss of earnings.
33. If the payment does not meet these criteria, it will be assessable income.
34. The following diagram sets out the process for determining how an amount paid out under a policy should be treated. Each payment needs to be considered

separately. As noted above, where a single payment is made for more than one thing, apportionment may be required:

Treatment of payment made to a person under a policy of personal sickness or accident insurance



Example

35. The following example is included to assist in explaining the application of the law.
36. **Keith's employer takes out medical insurance policies for each of its senior staff.** The policies pay out various amounts if the insured person contracts a disease or becomes sick. **Keith's employer is allowed a deduction for the premiums.** The premiums are subject to FBT because a fringe benefit arises under s CX 16(6).
37. Keith contracts influenza and is hospitalised. Keith receives a \$10,000 payment as a reimbursement of his hospital expenses. Keith wants to know whether to include the \$10,000 in his income.
38. The \$10,000 is not income. The amount is not income under ordinary concepts. It is a one-off payment. Also, it is not paid to compensate Keith for lost income.

References

Related rulings/statements

"Life and accident insurance policies" *Public Information Bulletin* No 106 (July 1980): 2
"Staff insurance schemes" *Public Information Bulletin* No 70 (December 1972): 11

Subject references

Expenditure on account of an employee
FBT
Fringe benefit
Income protection insurance
Life insurance
Personal sickness or accident insurance

Legislative references

Income Tax Act 2007, ss CA 1, CE 1(1), CE 5, CE 11, CX 2, CX 16, CX 31, CX 37, DA 1, DA 2, GB 32, RD 3, RD 5(2) and the definitions of "expenditure on account of an employee" and "salary or wages" in s YA 1

Case references

FCT v Hyteco Hiring Pty Ltd 92 ATC 4,694
Reid v CIR (1985) 7 NZTC 5,176