


***CR 2005/103 - Fringe benefits tax and income tax:
payments by employer members of IPT Co Ltd for
income protection and trauma insurance policies***

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Class Ruling

Fringe benefits tax and income tax:
payments by employer members of IPT
Co Ltd for income protection and trauma
insurance policies

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Preamble

*The number, subject heading, **What this Class Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. CR 2001/1 explains Class Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a 'public ruling' and how it is binding on the Commissioner.*

What this Class Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

Tax law(s)

2. The tax laws dealt with in this Ruling are:

- section 40 of the *Fringe Benefits Tax Assessment Act 1986* (FBTAA);
- section 45 of the FBTAA;
- section 51 of the FBTAA;
- section 52 of the FBTAA;
- subsection 58J(2) of the FBTAA;
- subsection 136(1) of the FBTAA;
- subsection 148(2) of the FBTAA;
- section 152A of the FBTAA; and
- section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997).

Class of persons

3. The class of persons to which this Ruling applies is all employer members (participating employers) of IPT Co Ltd (IPT). Those participating employers will pay insurance premiums to IPT, a company limited by guarantee, to cover nominated insured workers (employees) under the following group policies:

- (a) QBE Insurance (Australia) Limited insurance policy in respect of Leisure Time Injury & Illness, TAC Top Up policy and Workers Compensation Top Up policy (Income Protection Insurance Policy); and
- (b) QBE Insurance (Australia) Limited insurance policy in respect of personal accident (Trauma Insurance Policy).

Qualifications

4. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.

5. The class of persons defined in this Ruling may rely on its contents provided the arrangement actually carried out is carried out in accordance with the arrangement described in paragraphs 9 to 15.

6. If the arrangement actually carried out is materially different from the arrangement that is described in this Ruling, then:

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

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Date of effect

8. This Ruling applies from 1 April 2005. Further, this Ruling only applies to the extent that:

- there is no material change in the arrangement or in the class of persons involved in the arrangement;
- it is not later withdrawn by notice in the *Gazette*;
- it is not taken to be withdrawn by an inconsistent later public ruling; or
- the relevant tax laws are not amended.

Arrangement

9. The arrangement that is the subject of the Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- Ruling application dated 10 March 2005 by Deacons on behalf of participating employers of IPT Co Ltd;
- Draft constitution of IPT Co Ltd (Constitution) as amended 21 January 2005;
- Pro forma QBE Mercantile Mutual Limited Income Protection Insurance Policy; and
- Pro forma QBE Mercantile Mutual Limited Trauma Insurance Policy.

10. IPT is a company limited by guarantee which has been formed to provide services to its members being respectively the foundation member and the participating employers. The foundation member will be the Redundancy Payment Central Fund Ltd (Incolink) whose board is equally constituted by representatives of employer associations and employee unions.

11. Employees are covered by workers compensation law under the *Accident Compensation Act 1985* (Victoria) (the Accident Compensation Act) which provides compensation where an employee is injured during working hours.

12. Participating employers have an obligation to provide insurance benefits to their workers which arise under various industrial instruments or employment agreements applicable to the Victorian construction industry.

13. To satisfy the obligation each participating employer, under their contract with IPT, is to pay insurance premiums to IPT. These premiums will be received by IPT as agent for the employer, and will be paid by IPT to the insurer on the employer's behalf. Those premiums are for the relevant policies to secure benefits for each of the participating employer's insured employees. The relevant policies are as stated in paragraph 3.

14. Each insured nominated employee is covered under the group policy of the insurer. The initial overall premium for each insured employee, payable by a participating employer to the insurer, will be \$13.09 per week. That initial overall premium will contain separate components for each of the insurer's income protection and trauma insurance policies.

15. When an employee makes a claim against the insurer under a relevant policy, IPT on request from the insurer, will confirm the eligibility of that employee to make a claim. All benefits payable under the insurer's income protection policy and trauma policy will be paid directly to the insured employee.

Ruling

Fringe benefits tax

Payments to IPT by participating employers

16. The payment of premiums to IPT by participating employers in respect of income protection insurance and trauma insurance is not a fringe benefit.

Provision of income protection insurance cover

17. The provision of income protection insurance cover as described in the arrangement, by the insurer to employees of a participating employer, will be a fringe benefit as defined in subsection 136(1) of the FBTA. Specifically it will be a residual fringe benefit for the purposes of Division 12 of Part III of the FBTA.

18. For the purpose of determining the taxable value, such a benefit will be an external period residual fringe benefit under section 51 of the FBTA. The taxable value will be calculated under paragraph 51(b) and will be the amount of the premium paid by the participating employer to the insurer (through IPT as agent).

19. Where an appropriate declaration is provided, the taxable value of a fringe benefit which relates to the insurer's income protection insurance policy will be reduced to nil. This will occur by the operation of the otherwise deductible rule, pursuant to section 52 of the FBTA.

Provision of trauma insurance cover

20. The provision of trauma insurance cover as described in the arrangement, by the insurer to an employee of a participating employer, is not a fringe benefit as defined in subsection 136(1) of the FBTA. Specifically it will be an exempt benefit for the purposes of subsection 58J(2) of the FBTA.

Payments by the insurer to an insured employee

21. The payment of an amount to an insured employee arising under the insurer's income protection policy or trauma insurance policy will not be a fringe benefit for the purposes of subsection 136(1) of the FBTA.

22. The lump sum payment to relatives of a person who was an employee of a participating employer in respect of the death of that person is not a fringe benefit for the purpose of subsection 136(1) of the FBTA.

Income tax

23. The amount of a premium payable by a participating employer to the insurer (through IPT as agent) under the insurer's income protection policy or the insurer's trauma insurance policy will be deductible under section 8-1 of the ITAA 1997. This is subject to the condition that it does not relate to the earning of exempt income by the employer.

Explanation**Fringe benefits tax*****Payment by an employer to IPT***

24. The definition of a fringe benefit in subsection 136(1) of the FBTA provides that a benefit will be a fringe benefit when that benefit is provided to an employee or an associate of the employee in respect of the employment of the employee by an employer (or its associate) or under an arrangement between the employer and a third party, unless the benefit is specifically excluded from being a fringe benefit.

25. As described in the arrangement, payments will be made by a participating employer to IPT, which in accordance with Taxation Ruling TR 1999/5 may give rise to a property benefit. The Ruling provides that a payment of money by an employer in appropriate circumstances to the trustee of a trust in respect of the employment of an employee, which does not constitute salary or wages or is otherwise exempt by virtue of subsection 136(1), is a property benefit pursuant to section 40 of the FBTA. To be a fringe benefit such a payment must be provided to an associate of an employee in respect of the employment of the employee.

26. A trustee may be considered to be an associate of an employee for the purposes of the definition of a fringe benefit. However, under the arrangement as described, IPT acting as agent for the employer will not hold moneys in trust for the benefit of employees and will not therefore be considered to be an associate of an employee for the purposes of the definition of a fringe benefit.

27. Subsection 148(2) of the FBTA also provides that a person (including a trustee) is deemed to be an associate of an employee, where:

- a benefit is provided to that person (who is not an employee or otherwise an associate of an employee);
- under an arrangement between the employer and the employee or an associate of an employee; and
- which is provided in respect of the employment of the employee.

28. It is considered that the payment of money by a participating employer to IPT acting as agent for the employer will be made pursuant to an arrangement for the purposes of subsection 148(2) of the FBTA. However, such a benefit being the payment of money provided under an arrangement will only be a fringe benefit if it is provided in respect of the employment of an employee.

29. The expression 'in respect of' is defined in subsection 136(1) as including 'by reason of, by virtue of, or for or in relation directly or indirectly'. The term has been considered by the courts on numerous occasions. In *J & G Knowles & Associates Pty Ltd v. Federal Commissioner of Taxation* (2000) 96 FCR 402; 2000 ATC 4151; (2000) 44 ATR 22; 2000 FCA 196 (*Knowles*) it was noted that the term 'in respect of employment' includes benefits where:

... there is a sufficient or material, rather than a causal connection or relationship between the benefit and the employment...

30. A participating employer will make payments to IPT as the agent in order to meet its insurance obligations as outlined in the relevant industry awards and agreements. However, the method of and reason for the payments is merely an outcome of a decision by the employer as to how it will meet its obligation under the relevant industrial instrument or employment agreement.

31. It is therefore considered that, in these circumstances, the benefit provided by the participating employer in the form of a payment to IPT as agent for the employer will have a causal connection with the employment of an employee but will not possess a sufficient or material connection to the employment of an employee of that employer as suggested in *Knowles*. Accordingly, that benefit will not be provided in respect of the employment of an employee.

32. As a payment made by a participating employer to IPT will not be a benefit provided in respect of the employment of an employee, it will not be a fringe benefit as defined in subsection 136(1) of the FBTA.

Provision of income protection insurance cover

33. The definition of a benefit in subsection 136(1) of the FBTA specifically includes rights, benefits and privileges provided under an insurance contract. Accordingly, the arrangement that a participating employer will have with the insurer to provide income protection insurance cover to its employees is clearly a benefit for the purposes of subsection 136(1) of the FBTA.

34. Because of the specific nature (and in this instance non relevance) of the benefits covered by Divisions 2 to 10 of Part III of the FBTA, it is considered that such a benefit will either be a property benefit (Division 11) or residual benefit (Division 12).

35. A benefit will only be a residual benefit if it is not a benefit pursuant to Divisions 2 to 11 (section 45), more specifically in this instance that it is not a property benefit. Property is defined to mean intangible property or tangible property. Tangible property is basically defined as being goods and intangible property specifically excludes a right arising under a contract of insurance.

36. Therefore, it is concluded that the rights of an employee arising under a contract for the provision of income protection insurance provided by the insurer under an arrangement with a participating employer will be a residual benefit.

37. A residual benefit will be a fringe benefit as defined in subsection 136(1) if it is provided in respect of the employment of an employee. The provision of the insurance cover by a participating employer to an employee arises under an obligation pursuant to an industrial instrument which governs the employment relationship. Accordingly, it is considered that the provision of the insurance cover will have a sufficient or material connection with the employment of the employee, such that it will be a residual fringe benefit.

38. The taxable value of a residual benefit is ascertained under Subdivision B of Division 12 of Part III of the FBTA. By virtue of the various definitions pertaining to in-house benefits (it is not in-house) and the definition of a period residual fringe benefit it is concluded that the benefit will be an external period residual fringe benefit. Therefore the taxable value is determined under section 51 of the FBTA.

39. The provider of the insurance cover under the arrangement will be the insurer and because a participating employer is expected to pay for the insurance cover under an arm's length transaction, the taxable value will be calculated under paragraph 51(b) and will be the amount paid by the employer for that cover.

40. The taxable value of such a residual fringe benefit provided by a participating employer will be reduced by the operation of section 52 of the FBTA (the otherwise deductible rule) where:

- the employee who receives the benefit gives the employer a declaration in respect of the benefit; or
- the benefit is covered by a recurring fringe benefit declaration for the purposes of section 152A of the FBTA; and
- some or all of the amount of the premium paid by the employer is otherwise deductible.

41. The otherwise deductible rule operates to reduce the taxable value of a fringe benefit by an amount equal to the amount that would have been allowed as a deduction to a recipient employee if they had incurred the outgoing in relation to the benefit.

42. As explained in paragraphs 22 to 26 of Class Ruling CR 2002/57, it is well established that premiums paid in respect of income protection insurance policies which provide for payment of periodic benefits of an income nature are deductible to the policy holder. Clearly, in the circumstances of this arrangement, if an employee incurred the cost of the premiums in relation to the insurer's income protection policies such an expense would be deductible to that employee under section 8-1 of the ITAA 1997.

43. Accordingly, where an appropriate declaration is provided as set out in paragraph 40, the taxable value of a fringe benefit which relates to the insurer's income protection policy will be reduced to nil under the otherwise deductible rule.

Provision of trauma insurance cover

44. The definition of a benefit in subsection 136(1) of the FBTA specifically includes rights, benefits and privileges provided under an insurance contract. Accordingly, the arrangement that a participating employer will have with the insurer to provide trauma insurance cover to its employees is clearly a benefit for the purposes of subsection 136(1) of the FBTA.

45. Under the trauma insurance policy an employee of a participating employer or a relative of an employee may receive a lump sum payment from the insurer where injury results in the permanent total disablement of an employee. A relative of an employee may receive a lump sum payment where injury results in the death of the employee.

46. A benefit constituted by a contingent right to receive benefits for compensable work-related trauma may be an exempt benefit under subsection 58J(2) of the FBTA. The contingent right may arise under a contract of insurance or otherwise.

Compensable work-related trauma

47. A compensable work-related trauma is defined in section 136(1) of the FBTAA to mean, broadly, an injury or disease related to the employment of an employee where the employee is entitled to receive compensation or other benefits in respect of the injury or disease under a workers' compensation law.

48. A 'workers compensation law' is defined in subsection 136(1) of the FBTAA as meaning a law that provides for compensation or other benefits for work-related trauma suffered by employees without requiring proof of any breach by the employer, or persons associated with the employer.

49. The Accident Compensation Act at section 82 confirms that compensation may be available where an employee is injured during working hours. Subsection 82(2) of the Accident Compensation Act extends the cover where injury results in the death of the employee. Therefore it is accepted that benefits are provided only in respect of compensable work related trauma for the purpose of subsection 58J(2).

Contingent right

50. To be exempt under subsection 58J(2), a benefit must be constituted by the subsistence of a contingent right to a benefit for or in respect of compensable work-related trauma suffered by the employee.

51. It is considered that the trauma insurance policy conveys to an employee or a relative a contingent right to receive the benefit of a lump sum payment in respect of permanent total disablement, or the death of the employee as a result of bodily injury. The contingent right is extinguished when the employee is entitled to receive all the benefits pertaining to that trauma. Therefore, the contingent right that is provided in respect of the provision of trauma insurance cover satisfies the conditions outlined in subsection 58J(2) of the FBTAA.

52. Therefore the provision of cover in respect of trauma insurance by the insurer is an exempt benefit pursuant to subsection 58J(2) of the FBTAA.

Payments by the insurer to an insured employee*Income protection insurance policy*

53. Any payment by the insurer to an employee covered under the insurer's income protection policy or trauma insurance policy will be made because the employee is an insured person under the participating employer's policy and because an insurable event in the terms of the policy will have occurred.

54. Following the decision in *FC of T v. DP Smith* 81 ATC 4114; 11 ATR 538 it has been accepted that the payment of periodic benefits to compensate an employee for the loss of income during a period of incapacity is assessable income to the employee. To this extent the income protection policy provided by the insurer is similar to the policy described in Class Ruling CR 2002/57 which was designed to replace a proportion of a policy holder's income where that person suffers a sickness or injury and cannot work.

55. It is considered that payments in respect of the income protection policy compensate an employee for the loss of salary and wages. A payment that constitutes salary or wages is specifically excluded from the definition of a fringe benefit pursuant to subsection 136(1) of the FBTAA. Thus, the payment of an amount to an insured employee arising under the insurer's income protection policy will not be a fringe benefit for the purposes of subsection 136(1) of the FBTAA.

Trauma insurance policy

Permanent total disablement

56. As described in the arrangement employees may receive a lump sum payment from the insurer where a work place injury results in the permanent total disablement of the employee. Income Tax Ruling IT 2193 confirms the decision in *FCT v. Slaven* 84 ATC 4077; 15 ATR 242 that a payment which is compensation for the deprivation or impairment of earning capacity is a payment of capital. It is considered that payments in respect of the permanent total disablement of the employee are of a capital nature and therefore specifically excluded from the definition of a fringe benefit pursuant to subparagraph 136(1)(m)(ii) of the FBTAA.

Death

57. Subsection 136(1) of the FBTAA requires that for a fringe benefit to exist there must be a benefit provided to an employee or to an associate of the employee. The addendum to paragraph 87 of Taxation Ruling TR 1999/10 confirms that a benefit received by a relative of a deceased person is not considered to be a benefit provided to an employee or an associate of an employee. Therefore the payment is not subject to fringe benefits tax as defined in subsection 136(1) of the FBTAA.

Income tax***Payments to IPT by participating employers***

58. Subsection 8-1(1) of the ITAA 1997 allows a deduction for all losses and outgoings to the extent to which they are incurred in gaining or producing assessable income or are necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income. However, subsection 8-1(2) of the ITAA 1997 prevents a deduction under subsection (1) where the outgoings are of a capital, private or domestic nature, or relate to the earning of exempt income.

59. For expenditure to be deductible under section 8-1 of the ITAA 1997 there must be a sufficient nexus or relationship between the outgoing and the production of assessable income so that the outgoing is incidental and relevant to the gaining or producing of assessable income (*Ronpibon Tin & Tongkah Compound NL v. FC of T* (1949) 78 CLR 47).

60. Where a participating employer makes a payment of a premium under the insurer's income protection policy or trauma insurance policy, they will do so in order to fulfil an obligation imposed on them under an industrial instrument. That obligation includes the provision of insurance benefits to its employees. The payment of premiums will be necessarily incurred in carrying on the employer's business because the payment is a necessary cost involved in employing workers.

61. The outgoing will therefore be incidental and relevant to the ends of the business and a deduction will be allowed under subsection 8-1(1) of the ITAA 1997 as long as it is not of a capital, private or domestic nature, or relates to the earning of exempt income.

62. The payment of an insurance premium is clearly not of a private or domestic nature as it is only paid in relation to employees engaged in the business of their employer. Likewise such a payment is not a capital expense or of a capital nature. The payment has the character of a business expense similar to other costs associated with employing workers, such as wages and superannuation contributions. Unlike a payment of a capital nature the payment does not secure any enduring benefit for the employer. Rather it discharges an obligation imposed upon the employer.

63. Whether or not an expense relates to the earning of exempt income will depend on the circumstances applying to each participating employer, the nature of their business activities and the income they derive.

64. Therefore, where the payment of a premium by a participating employer is made under the insurer's income protection policy or trauma insurance policy in order to satisfy an obligation imposed on the employer by an industrial instrument, it will be an allowable deduction under section 8-1 of the ITAA 1997. This is subject to the condition that it does not relate to the earning of exempt income by the employer.

Detailed contents list

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Commissioner of Taxation

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<i>Previous draft:</i>	- FBTA 1986 52
Not previously issued as a draft	- FBTA 1986 58J(2)
	- FBTA 1986 136(1)
<i>Related Rulings/Determinations:</i>	- FBTA 1986 136(1)(m)(ii)
CR 2001/1; CR 2002/57; TR 92/1;	- FBTA 1986 148(2)
TR 97/16; TR 1999/5;	- FBTA 1986 152A
TR 1999/10; IT 2193	- ITAA 1997 8-1
	- ITAA 1997 8-1(1)
<i>Subject References:</i>	- ITAA 1997 8-1(2)
- exemptions	- TAA 1953 Pt IVAAA
- income tax deductions	- Accident Compensation Act 1985 (Vic)
- provision of fringe benefits	- Accident Compensation Act 1985 (Vic) 82
- reductions	- Accident Compensation Act 1985 (Vic) 82(2)
<i>Legislative References:</i>	
- Copyright Act 1968	<i>Case References:</i>
- FBTA 1986 Pt III Div 2	- J & G Knowles & Associates Pty Ltd v. Federal Commissioner of Taxation (2000) 96 FCR 402; 2000 ATC 4151; (2000) 44 ATR 22; 2000 FCA 196
- FBTA 1986 Pt III Div 3	- Ronpibon Tin & Tongkah Compound NL v. FC of T (1949) 78 CLR 47
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- FBTA 1986 51	
- FBTA 1986 51(b)	

ATO references

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