


TD 94/D24 - Income tax: life assurance: are any of the premiums paid by an employer under a 'split purpose' insurance arrangement an allowable deduction?

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This document has been finalised by TD 94/40.

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Draft Taxation Determination

Income tax: life assurance: are any of the premiums paid by an employer under a 'split purpose' insurance arrangement an allowable deduction?

1. No. No part of any premiums paid by an employer under a 'split purpose' insurance arrangement is an allowable deduction to the employer. The use of the arrangement to provide 'key person' benefits does not change the situation.
2. A split purpose insurance arrangement is said to exist where one party owns all or part of both the investment and risk components of a life insurance policy and states that each component is held for a separate and distinct purpose. For example, an employer may claim he or she holds the risk component for a revenue purpose and the investment component for a capital purpose.
3. Taxation Ruling IT 155 which deals with 'key person' insurances, acknowledges that a deduction may be allowable for certain premiums paid on a life insurance policy. The premiums must be in respect of a term policy or divisible to a term rider to a life assurance policy. Deductibility is then determined by whether the premiums were paid for a revenue purpose.
4. Taxation Ruling IT 155 was modified by Taxation Ruling IT 2434 which deals with 'split dollar' insurance arrangements. By way of explanation, a 'split dollar' arrangement exists where two parties agree, under a written legally binding agreement, that each owns one of the two components of a life insurance policy. Split dollar policies are mainly used by employers and employees - refer paragraph 4, IT 2434. Usually, the employer owns and is entitled to the benefits of the term component of the policy while the employee owns and is entitled to the investment component of the policy.
5. IT 2434 states that a split dollar arrangement is acceptable provided it results in no greater taxation advantage than if the two parties separately arranged their insurance needs. If this requirement is met each party will be treated as having paid the particular component of the policy owned by them under the arrangement. Paragraph 14, IT 2434 states that premiums payable will be income tax deductions to the extent that the amounts can be said to represent loss or outgoings incurred in gaining or producing assessable income. As stated in IT 155, the term component of a life insurance policy must be taken out by the employer for a revenue purpose in order for the employer's share (or split) of the premium to be deductible. Premiums in respect of an investment component are not deductible.

6. There is a significant difference between a split dollar arrangement and a split purpose arrangement. With a typical split dollar arrangement an employer who wants to take out a term life policy achieves that result by acquiring only the risk component of a permanent life policy at a cheaper rate. What the employer acquires is set out in the policy and in the associated split dollar agreement.

7. With a split purpose arrangement the situation, in reality, is that the employer is the sole owner of a permanent life insurance policy. There is no legal division of the benefit entitlements under the policy as there is under a split dollar arrangement. Upon maturity (at death or the attainment of the stated date) or surrender of the policy the employer receives a single amount the whole of which is, in normal circumstances, treated as a capital receipt.

8. The usual practice in relation to life insurance policies as stated in IT 155 therefore apply to split purpose insurance arrangements. That is the life insurance premiums paid are not allowable deductions as they are paid in respect of a permanent life policy which is owned (in full) by the taxpayer.

9. If monies are borrowed to pay any part of the premiums on a life policy involved in a split purpose arrangement the interest payable on those borrowings is not an allowable deduction because a split purpose arrangement is based on a permanent life policy the proceeds of which do not constitute assessable income - refer Taxation Ruling 2504 and section 67AAA.

Commissioner of Taxation

3/3/94

FOI INDEX DETAIL: Reference No.

Related Determinations:

Related Rulings: IT 155, IT 2434, IT 2504

Subject Ref: life companies; deduction for premiums paid under split purpose arrangement.

Legislative Ref: ITAA 51(1), 67AAA

Case Ref:

ATO Ref: Insurance Industry Cell.

ISSN 1038 - 8982