IT 208 - Disability insurance - deductibility of premiums and assessability of benefits

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TAXATION RULING NO. IT 208

DISABILITY INSURANCE - DEDUCTIBILITY OF PREMIUMS AND ASSESSABILITY OF BENEFITS

F.O.I. EMBARGO: May be released

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F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1102261	DISABILITY INSURANCE	25(1)
	INSURANCE PREMIUMS	26(j)
	SMITH (DP) v FC OF T	51(1)

PREAMBLE In FC of T v D.P. Smith 81 ATC 4114; 11 ATR 538, the High Court unanimously dismissed the Commissioner's appeal in relation to the deductibility of a premium paid for the renewal of a personal disability insurance policy, finding that the expenditure was deductible under section 51(1). The Court also unanimously dismissed the taxpayer's cross-appeal in relation to the assessability of benefits received under the policy, finding that the proceeds were assessable by reason of section 25(1) and additionally, per Gibbs, Stephen, Mason and Wilson JJ in a joint judgment, that the proceeds were assessable under section 26(j).

2. The decision of the High Court confirmed the unanimous decision of the Federal Court reported at 79 ATC 4553; 10 ATR 301 which reversed the decision of the Supreme Court of Western Australia (Wickham J) reported at 78 ATC 4741; 9 ATR 389.

3. The facts of the appeal were that the taxpayer, a medical practitioner employed by a hospital, had for several years paid a premium in respect of a personal disability insurance policy. The policy provided that the insurer would pay a monthly indemnity during any period of total disability sustained by the taxpayer as the result of injury. The benefit was not payable in respect of the first thirty days of disability and was to be reduced by any amounts paid under Workers' Compensation legislation.

4. On 19 October 1977 the taxpayer was injured in a motor vehicle accident and as a result, became entitled to receive payments under the policy amounting to $2112. After resuming his duties at the hospital the taxpayer renewed the policy when it fell due on 1 June 1978 paying an amount of $91. It was the deductibility of that expenditure and the assessability of the $2112 benefit which the High Court was asked to consider.

5. The decision in relation to the assessability of the benefits received (including the bonus), confirms the current practice of the Commissioner of including periodic benefits payable under a disability insurance policy in the assessable

income under the provisions of sections 25(1) or 26(j).

6. In relation to the deductibility of the premium pursuant to section 51(1) the High Court rejected the Commissioner's submissions that the expenditure was not incurred in gaining the assessable income, that there was an insufficient connection between the outgoing of the premium and the receipt of the benefit because there was an intermediate step interposed viz. the occurrence of certain stipulated events, that each successive annual premium initiates a new policy (there being no income receipt from the policy renewed by payment of the subject premium), that the advantage sought to be gained by the payments of benefit and this promise was a capital advantage and finally that the outgoing was of a capital or private nature.

7. Instead the members of the court participating in the joint judgment found that there was a sufficient connection between the purchase of the cover against the loss of ability to earn and the consequent earning of assessable income to bring the premium within the first limb of section 51(1). The periodic nature of the premium payment and other provisions in the policy which contemplated its renewal from year to year militated against its characterisation as an outgoing of a capital nature. Without giving reasons the court also considered that the payment could not assume a private or domestic nature.

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8. The decision should be applied in all cases where taxpayers have paid premiums in respect of personal disability insurance policies which provide for payment of periodic benefits of an income nature during a period of incapacity. The insurance policy under consideration by the High Court did not provide for non-assessable benefits such as a lump sum payment in the event of death, permanent disablement, loss of limb, etc. so that the previous instruction to disallow premiums to the extent that they provide such benefits remains operative.

9. The decision of the High Court is not seen as providing authority for the proposition that the superannuation contributions or other payments made to provide an annuity are deductible under section 51(1). Such amounts, to the extent that they satisfy the provisions of section 159R, should continue to be treated as rebatable amounts under that section.

COMMISSIONER OF TAXATION