


***CR 2004/113 - Fringe benefits tax and income tax:
payments by employer members of Construction
Income Protection Ltd for worker income protection
and portable sick leave insurance policies***

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Class Ruling

Fringe benefits tax and income tax:
payments by employer members of
Construction Income Protection Ltd for
worker income protection and portable
sick leave insurance policies

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Preamble

*The number, subject heading, **What this Class Ruling is about** (including **Tax laws**, **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 laws' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

Tax laws

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;
- section 136 of the FBTAA;
- section 148 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 employers who become B Class Members (participating employers) of Construction Income Protection Ltd (CIP). Those participating employers will pay insurance premiums to cover nominated insured workers (employees) under the following group policies:

- (a) Construction Income Protection Ltd Leisure Time Injury & Illness plus Workers Compensation Top Up Policy (income protection policy); and
- (b) Construction Income Protection Ltd Portable Sick Leave Insurance Policy (portable sick leave policy).

This ruling does not apply to B Class members of CIP who are self employed.

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 16.

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 2004. 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 21 November 2003 by Blake Dawson Waldron on behalf of B Class Members of a company to be incorporated;
- Notification of modified ruling application dated 13 September 2004 by Blake Dawson Waldron on behalf of B Class Members of CIP;
- A letter from CIP dated 10 September 2004 confirming modified application;
- The draft Constitution of a company to be incorporated (Draft No 6, 15 October 2003);
- The final copy of the Constitution of Construction Income Protection Ltd, dated 6 September 2004 (the final CIP constitution);
- A facsimile from Blake Dawson Waldron dated 10 September 2004 confirming modified application and final CIP constitution;
- A pro forma for the QBE Mercantile Mutual Limited (the insurer) portable sick leave insurance policy (the portable sick leave policy);
- A pro forma for the QBE Mercantile Mutual Limited leisure time injury & illness plus workers compensation top up policy (the income protection policy); and

- A letter dated 21 September 2004 by Blake Dawson Waldron confirming that the title of the insurance policies to be issued to Construction Income Protection Ltd, is as stated in paragraph 3.

10. CIP is a public company limited by guarantee and was formed to provide services to its members being A Class and B Class members. The A Class members of CIP will be employer associations and employee unions involved in the Queensland construction industry. The B class members will be participating employers who are involved in the Queensland construction industry who employ at least one employee.

11. Participating employers have an obligation to provide insurance benefits to their employees which arises under various industrial instruments or employment agreements, which apply in the construction industry in Queensland.

12. To satisfy that obligation, each participating employer under their contract with CIP, is to pay insurance premiums to CIP. Those payments will be received by CIP as agent for the employer, and will be paid by CIP 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.

13. The contract for the relevant policies will be between CIP (as agent for the participating employers) and the insurer. Participating employers will also pay membership fees to CIP.

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 \$9 per week or \$468 per annum. That initial overall premium will contain separate components for each of the insurer's income protection and portable sick leave policies.

15. CIP has advised that the capital benefits component of the original insurer's income protection policy has now been excluded from that policy and is no longer a benefit available to insured employees.

16. When an employee makes a claim against the insurer under a relevant policy, CIP 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 the portable sick leave policy will be paid directly to the insured employee.

Ruling

Fringe benefits tax

Provision of insurance cover

17. The provision of the 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 FBTAA. Specifically it will be a residual fringe benefit for the purposes of Division 12 of Part III of that Act.

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 FBTAA. The taxable value will be calculated under subsection 51(b) and will be the amount of the premium paid by the participating employer to the insurer (through CIP as agent).

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

Payments by the insurer to an insured employee

20. The payment of an amount to an insured employee arising under the insurer's portable sick leave policy or income protection policy will not be a fringe benefit for the purposes of subsection 136(1) of the FBTAA.

Income Tax

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

Explanation

Fringe benefits tax

Payment by an employer to CIP

22. The definition of a fringe benefit in subsection 136(1) of the FBTAA 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.

23. As described in the Arrangement, payments will be made by a participating employer to CIP, 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 payment must be provided to an associate of an employee in respect of the employment of the employee.

24. 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, CIP 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.

25. 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,
- which is provided in respect of the employment of the employee.

26. It is considered that the payment of money by a participating employer to CIP 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.

27. 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, (*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...

28. A participating employer will make a payment to CIP primarily because it has an obligation to provide insurance cover for its employees. That obligation arises under an industrial instrument, and originates from the employer's participation in the construction industry in Queensland. However, the method of and reason for that

payment is merely a reflex of a decision by the employer as to how it will meet its obligation under the relevant industrial instrument.

29. It is therefore considered that, in these circumstances, the benefit provided by the participating employer in the form of a payment to CIP 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.

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

Provision of insurance cover

31. 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 various categories of insurance to its employees is clearly a benefit for the purposes of the FBTA.

32. 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).

33. 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.

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

35. 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.

36. 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 and

therefore the taxable value is determined under section 51 of the FBTA.

37. 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 subsection 51(b) and will be the amount paid by the employer for that cover.

38. 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 1986, and
- some or all of the amount of the premium paid by the employer is otherwise deductible.

39. 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.

40. 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 policy or the insurer's portable sick leave policy, such an expense would be deductible to that employee under section 8-1 of the ITAA 1997.

41. Accordingly, where an appropriate declaration is provided as set out above in paragraph 38, the taxable value of a fringe benefit which relates to the insurer's income protection policy or the insurer's portable sick leave policy will be reduced to nil under the otherwise deductible rule.

Payments by the insurer to an insured employee

42. Any payment by the insurer to an employee covered under the insurer's portable sick leave policy or income protection 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.

43. Some of these payments by the insurer to an employee will be specifically excluded from the definition of a fringe benefit in subsection 136(1) of the FBTA because they will be a payment of salary or wages (as defined in subsection 136(1)). Any payments that

are not so excluded will also not be a fringe benefit because they will not have the sufficient or material connection with employment as referred to above in paragraphs 27 and 29. They will have a causal connection with the employment of the employee but this is not sufficient to trigger the application of fringe benefits tax.

44. Thus, the payment of an amount to an insured employee arising under the insurer's portable sick leave policy or income protection policy will not be a fringe benefit for the purposes of subsection 136(1) of the FBTA.

Income Tax

45. 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.

46. 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).

47. Where a participating employer makes a payment of a premium under the insurer's portable sick leave policy or income protection 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.

48. 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.

49. 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.

50. 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.

51. Therefore, where the payment of a premium by a participating employer is made under the insurer's portable sick leave policy or income protection 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 proviso that it does not relate to the earning of exempt income by the employer.

Detailed contents list

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Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

CR 2001/1; TR 92/1; TR 97/16;
CR 2002/57; TR 1999/5

Subject references:

- deductions
- provision of fringe benefits
- reductions

Legislative references:

- Copyright Act 1968
- FBTAA 1986 Pt III Div 2
- FBTAA 1986 Pt III Div 3
- FBTAA 1986 Pt III Div 4
- FBTAA 1986 Pt III Div 5
- FBTAA 1986 Pt III Div 6
- FBTAA 1986 Pt III Div 7
- FBTAA 1986 Pt III Div 8
- FBTAA 1986 Pt III Div 9
- FBTAA 1986 Pt III Div 10
- FBTAA 1986 Pt III Div 11
- FBTAA 1986 Pt III Div 12

- FBTAA 1986 40
- FBTAA 1986 45
- FBTAA 1986 51
- FBTAA 1986 51(b)
- FBTAA 1986 52
- FBTAA 1986 136
- FBTAA 1986 136(1)
- FBTAA 1986 148
- FBTAA 1986 148(2)
- FBTAA 1986 152A
- ITAA 1997 8-1
- ITAA 1997 8-1(1)
- ITAA 1997 8-1(2)
- TAA 1953 Pt IVA

Case references:

- J & G Knowles & Associates Pty Ltd v. Federal Commissioner of Taxation (2000) 96 FCR 402; 2000 ATC 4151; (2000) 44 ATR 22
- Ronpibon Tin & Tongkah Compound NL v. FC of T (1949) 78 CLR 47).

ATO references

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