



## QUESTION WE'VE BEEN ASKED

**QB 18/03**

### **Income Tax – insurance – term life insurance policy taken out by employer for the benefit of an employee**

*This Question We've Been Asked (QWBA) considers the income tax treatment of term life insurance policies where an employer takes out the policy for the benefit of an employee.*

*This QWBA replaces QB 15/06: "Income Tax – Insurance – Term life insurance policy taken out by employer for the benefit of an employee" Tax Information Bulletin Volume Twenty Seven, No 6 (July 2015).*

*This QWBA applies from 30 March 2017.*

#### **Key provisions**

Sections CA 1, CE 1(1), CE 5, CX 2, CX 4, CX 16, DA 1, DA 2, GB 32, RD 3, RD 5(2) and the definition of "expenditure on account of an employee" in s YA 1 of the Income Tax Act 2007.

## Question

**What is the income tax treatment of a term life insurance policy that is:**

- **taken out by an employer (the employer is the policy holder), and**
- **an employee (or their spouse, civil union partner, de facto partner or child) is the beneficiary?**

**This item applies to both individual term life policies and group life policies where the employees (or associates) are the beneficiaries of the policy.**

## Answer

**The employer will generally be entitled to a deduction for the premiums paid.**

**The premiums paid will not be subject to PAYE.**

**The premiums paid will be subject to fringe benefit tax (FBT).**

**Lump sum claims paid on death under a term life insurance policy will not be taxable income of the employee (or the employee's estate).**

## Explanation

1. Inland Revenue 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that review, two items on the income tax treatment of insurance in an employment context were identified as **being out of date**.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. Those items were replaced with **a series of Questions We've Been Asked** (QWBAs) covering common scenarios.
2. Since those QWBAs were published changes have been made to the Income Tax Act to simplify the treatment of employer provided insurance. Those changes came into effect on 30 March 2017. It has, therefore, been decided to update and replace the affected QWBAs.
3. This QWBA considers the situation where a term life insurance policy is taken out by an employer for the benefit of an employee (or their spouse, civil union partner, de facto partner or child). The previous version of this QWBA was QB 15/06: "Income Tax – Insurance – Term life insurance policy taken out by employer for the benefit of an **employee**" *Tax Information Bulletin* Volume Twenty Seven, No 6 (July 2015). This QWBA does not cover the situation where an employee takes out a term life insurance policy and the employer pays the premiums. For discussion of that situation, see QB 18/02.
4. Term (or temporary) life insurance pays out the sum insured (as a lump sum claim) if the life insured dies during the term of the policy.

## Deductibility of premiums

5. 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 (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)).
6. 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 life insurance premium for the benefit of an employee (or their family) is a business **cost just like the employee's 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

7. **An employee's income includes "expenditure on account" of that employee** (s CE 1(1)(b)). Expenditure on account of an employee means a payment made by an employer relating to expenditure incurred by an employee (or to be incurred by an employee) (s CE 5(1)). In this case the employer has the legal obligation to pay the premium (as they have contracted with the insurance company to take out the policy). Consequently, the payment of the premium is not expenditure on account of an employee and is not subject to PAYE. It is, therefore, necessary to consider whether FBT applies.
8. Under s CX 2, a "fringe benefit" is a benefit that is provided by an employer to an employee in connection with their employment and comes within one of ss CX 6, CX 9, CX 10, or CX 12–CX 16, or is an unclassified benefit under s CX 37. Some benefits are

also excluded from being fringe benefits by specific provisions in subpart CX. None of those exclusions are relevant here.

9. It is the provision of the policy rather than any payment under the policy that is the **relevant "benefit" for FBT purposes**. The provision of a life insurance policy is an economic benefit to an employee as they received cover under the policy without the need to pay for it themselves.
10. Section CX 16 specifically includes life insurance policies as fringe benefits. It applies when an employer pays a "specified insurance premium". The definition of "specified insurance premium" **includes** a premium paid for the benefit of an employee on an insurance policy to the extent to which the insurance policy is for life insurance on the life of the employee or their spouse, civil union partner, or de facto partner, or on their joint lives, or on the life of their child (s CX 16(3)(a)). Section CX 16 will, therefore, apply to premiums paid for term life insurance.
11. There are no provisions in subpart CX that would exclude a term life insurance policy from being subject to FBT. Therefore, a term life insurance policy will be subject to FBT under s CX 16.
12. Where an employer provides a fringe benefit to a person associated with an employee, s GB 32 treats 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, subject to those exemptions, premiums paid on term life insurance policies 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**.

### **Income tax treatment of claims paid**

13. The claim proceeds received by an employee (or their estate) under a term life insurance policy are not income. An amount is income if it comes within a provision of Part C of the Act (s CA 1(1)). There are no specific provisions that tax payments under term life insurance policies.
14. An amount is also income if it is income under ordinary concepts (s CA 1(2)). A lump sum claim payment under a life insurance policy is not income under ordinary concepts.

### **Application date**

15. This QWBA reflects changes to ss CE 5 and CX 16, which came into force on 30 March 2017. The QWBA, therefore, applies from that date. For the position prior to 30 March 2017, see QB 15/06: "Income Tax – Insurance – Term life insurance policy taken out by employer for the benefit of an employee" (*Tax Information Bulletin* Volume Twenty Seven, No 6 (July 2015)).
16. The following example is included to assist in explaining the application of the law.

#### **Example**

Red Herring Fishing Ltd (RHF) takes out a term life insurance policy for one of its employees, Jared Stone. The policy is for a term of two years. The only benefit payable under the policy is if death occurs during the policy term. In such a **case, the sum insured is paid to the employee's estate. RHF pays the premiums.** RHF and Jared want to know the income tax implications of this arrangement.

RHF is allowed a deduction for the amounts of premium paid. The amounts of premium paid are subject to FBT under s CX 16. Any lump sum claim paid under

the policy will not be subject to income tax.

## References

### Subject references

Expenditure on account of an employee  
FBT  
Fringe benefit  
Life insurance

### Legislative references

Income Tax Act 2007: ss CA 1, CE 1(1), CE 5, CX 2, CX 4, CX 16, DA 1, DA 2, GB 32, RD 3, RD 5(2), and the definition of "expenditure on account of an employee" in s YA 1

### Other references

"Life and accident insurance policies" *Public Information Bulletin* No 106 (July 1980): 2  
"Staff insurance schemes" *Public Information Bulletin* No 70 (December 1972): 11  
QB 15/06: "Income Tax – Insurance – Term life insurance policy taken out by employer for the benefit of an employee" *Tax Information Bulletin* Volume Twenty Seven, No 6 (July 2015).