



Are insurance premiums tax deductible?

Although the question of whether insurance premiums are tax deductible may appear to be a rather basic tax question, it is not always clearly understood by business owners. Briefly, the issues on the deductibility of insurance premiums which you should discuss with clients are set out below.

All businesses have to pay insurance premiums of some sort. So, what are deductible and what are not?

In general terms, insurance premiums are deductible under the tax law if they have the necessary connection with earning assessable income or are necessarily incurred in carrying on a business for the purpose of earning assessable income.

Deductible premiums include those for workers compensation insurance, premiums paid by a self-employed person for disability insurance against loss of income, and professional indemnity insurance premiums.

The Tax Office allows a business a deduction for premiums for fire, theft, public liability, loss of profits and motor vehicle insurance, even though the insurance may cover capital assets or losses.

Premiums for "keyman" insurance will be deductible if the policy was taken out to protect revenue items. However, it is important to note that if the policy is taken out to protect against a capital loss (for example, to pay a sum to the key employee's estate on her or his death), the premiums will not be deductible.

No tax deduction is available for premiums payable on savings investment, endowment and life insurance policies, trauma insurance premiums (if the policy provides capital benefits).

The ATO has recently specifically stated that employees are allowed a tax deduction for annual premiums paid on an income protection policy that protects them from loss of income, even if the policy does not actually produce such income (see [ATO ID 2010/178](#)). The policies generally provide them with periodic benefits to protect them against loss of income.

In a 1981 High Court decision in *FCT v Smith* (1981) 11 ATR 538, the Court considered the tax deductibility of premiums paid for a personal disability insurance policy. The policy provided the taxpayer with a monthly indemnity against any income loss arising from an inability to earn.

The Court held that the premium was deductible because it was incidental and relevant to the operations and activities carried on to produce assessable income. This decision was not made by reference to the certainty or likelihood of the premium generating income, but by reference to its nature and character and its general connection with the taxpayer's activities which directly produced assessable income.

The majority of the High Court also concluded that the premiums were not of a capital, private or domestic nature. If this had been found, the premiums would not have been deductible.

The Tax Office considers that the periodic nature of the payment and other provisions in the policy which contemplate its renewal from year to year "militate against its characterisation as an outgoing of a capital nature".

Where the premiums paid are relevant and incidental to and, therefore, have a sufficient connection to the assessable income of the taxpayer, and are not of a capital, private or domestic nature, they will be deductible.

As can be seen, the basic principles surrounding the tax deductibility of insurance premiums are relatively straightforward. Insurance premiums are a necessary and important cost of doing business and all businesses should be clear on what they can claim on their tax return.