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Ruling

Subject: Deduction for future liability to pay benefit

Question 1

Is the Fund entitled to claim a deduction under section 295-470 of the *Income Tax Assessment Act 1997* (ITAA 1997)?

Answer

No.

This ruling applies for the following period:

2012 income year

The scheme commences on:

1 July 2011

Relevant facts and circumstances

The Fund is a self managed superannuation fund.

The Fund has three members: Member 1 (now deceased); Member 2 and Member 3.

Member 1 part owned several businesses.

Member 1 was employed up until the date of death.

Member 1's eligible service period commenced in late 19XX.

Member 1 died in 20XX.

Member 1 was over 55 years of age at the date of death.

In late 20XX, the Fund received a payout from Member 1's insurance policy (net of the premium payable).

The insurance policy is not in the possession of the Trustee.

The insurance policy was for "life insurance only and there were no underlying investments in the policy to create an underlying value".

The Fund has claimed a deduction for life insurance premiums for the 20ZZ, 20YY and 20XX financial years.

Ledger history provided indicates that the Fund paid insurance premiums as far back as June 200Y.

The Trustee has provided a copy of the Trustee Resolution - Minutes of the Directors Meeting held in June 20VV confirming a decision to not claim a deduction for the life insurance premium, as in previous years, and to claim a deduction under section 295-470, using the "future services deductions".

The Fund paid a death benefit as per subsection 295-460(a) to members 2 and 3 in the relevant income year.

Relevant legislative provisions

*Income Tax Assessment Act 1997* Section 295-460

*Income Tax Assessment Act 1997* Section 295-465

*Income Tax Assessment Act 1997* Section 295-470

Reasons for decision

Summary

The Fund cannot make a retrospective election to claim a deduction for a liability that no longer constitutes a future liability of the Fund.

Detailed reasoning

Subsection 295-465(1) of the ITAA 1997 provides that a complying superannuation fund can deduct the proportions specified in the table attached to the subsection of premiums it pays for insurance policies that are (wholly or partly) for current or contingent liabilities of the fund to provide benefits referred to in subsection 295-460 for its members. It can deduct the amounts for the income year in which the premiums are paid.

In this case, the life insurance premium for the relevant income year, was due in July 20XX. The premium wasn't actually paid by the fund when it fell due, but was instead deducted from the total life insurance to be paid out by the insurer.

A prerequisite for claiming a deduction under subsection 295-465 of the ITAA 1997 is that the premiums for relevant insurance policies are *paid*. As the premium was in fact paid (that is, withheld from the insurance payout), the Fund can claim a deduction for the insurance premium paid under subsection 295-465(1) of the ITAA 1997 in the relevant income year.

According to subsection 295-465(4) of the ITAA 1997, a trustee may choose not to deduct amounts under this section for an income year and to deduct instead (under section 295-470 of the ITAA 1997) amounts based on the fund's future liability to pay benefits.

Subsection 295-465(5) of the ITAA 1997 provides that this choice applies also to future income years unless the Commissioner decides that it should not.

Subsection 295-470(1) provides that a complying fund can deduct an amount under that subsection if the trustee has made a choice under subsection 295-465(4), the choice applies to the income year and the trustee pays a benefit of the kind described in section 295-460.

For the purposes of this case, section 295-460 provides sections 295-465 and 295-470 apply to a superannuation death benefit.

Subsection 295-470(2) provides that the amount the fund can deduct is the benefit amount multiplied by the future service days as a proportion of total service days.

The term 'future service days' is defined in subsection 295-470(2) as the number of days in the period starting when the termination happened, or when the member became unable to engage in gainful employment and ending on the member's last retirement day.

The term 'last retirement day' is defined by subsection 995-1(1) as meaning, if an individual's employment or office would have terminated when he or she reached a particular age or completed a particular period of service - the day he or she would reach the age or complete the period of service, or, in any other case, the day on which he or she would turn 65.

Therefore, the amount of the deduction under section 295-470 will decrease as the member approaches their last retirement day. If the member meets or exceeds their last retirement date the deduction under section 295-470 will be zero.

The effect of subsections 295-465(4) and (5) is that once a fund makes an election under subsection 295-465(4), they must claim deductions in accordance with section 295-470 and cannot revert to claiming deductions under subsection 295-465(1), unless the Commissioner decides otherwise. There is, however, nothing to prevent a fund from making an election under subsection 295-465(4) to claim deductions under section 295-470 instead of subsection 295-465(1), provided all the requirements of subsection 295-465(4) are met.

A key element of subsection 295-465(4) is that the amounts to be deducted under section 295-470 must relate to the fund's future liability to pay benefits.

The ITAA 1997 does not provide any guidance on what is meant by the phrase 'future liability to pay a benefit'. The word 'future' is defined by the Macquarie Dictionary as 'what will exist or happen in future time'. In light of this, it is possible to interpret the phrase in question as meaning a liability of the fund to pay a benefit which does not yet exist, but may come into existence on the happening of certain events in the future.

In this case, the trustees of the Fund became obliged to pay a death benefit to the beneficiaries at the time of the member's death. It was the occurrence of this event that caused the Fund's future liability to crystallise into a current liability.

Subsequent to the member's death, the Fund trustees resolved to make an election under subsection 295-465(4) in the relevant year to deduct an amount in relation to a benefit paid to the deceased member in accordance with section 295-470. The benefit was paid out to Members 2 and 3 in the relevant income year.

On the basis of the above, it cannot be said that there was a future liability to pay a benefit within the meaning of subsection 295-465(4) at the time the election was made. On the contrary, the Fund held a current liability to pay a benefit - an obligation which existed since the member's death. What the trustees have resolved to do is to make a retrospective election to claim a deduction for a liability that no longer constitutes a future liability of the Fund. As both subsection 295-465(4) and section 295-470 are premised on the basis of a future liability to pay benefits, it is not within the scope of these provisions for the trustees to make an election of this nature.

Accordingly, the Fund is not entitled to claim a deduction calculated in accordance with section 295-470 in relation to benefits paid out in respect of the deceased member for the relevant income year.

Conclusion

As the Fund did not hold a future liability to pay benefits at the time the election pursuant to subsection 295-465(4) of the ITAA 1997 was made, the Fund is not entitled to claim a deduction under section 295-470 of the ITAA 1997 in relation to benefits paid out in respect of the deceased member for the relevant income year.