TR 93/38 - Income tax and fringe benefits tax: taxation consequences of insurance companies providing interest free or low interest loans to insurance agents or their employees

Taxation Ruling

Income tax and fringe benefits tax: taxation consequences of insurance companies providing interest free or low interest loans to insurance agents or their employees

other Rulings on this topic

MT 2016; MT 2019

This Ruling, to the extent that it is capable of being a 'public ruling' in terms of Part IVAAA of the ***Taxation Administration Act 1953****, is a public ruling for the purposes of that Part. Taxation Ruling TR 92/1 explains when a Ruling is a public ruling and how it is binding on the Commissioner.*

What this Ruling is about

1. This Ruling is about the taxation consequences of insurance companies providing interest free or low interest loans to insurance agents or employees of insurance agents where the loans are used wholly or partly for private purposes.

Ruling

2. If an interest free or low interest loan is provided by an insurer to an insurance agent, the benefit received by the insurance agent is not a fringe benefit for the purposes of the *Fringe Benefits Tax Assessment Act 1986* (FBTAA). However, the benefit may be a non-cash business benefit within the meaning of that term in section 21A of the *Income Tax Assessment Act 1936* (ITAA). If so, the insurance agent will be assessable on an amount determined under section 21A of the ITAA in respect of the benefit.

3. If an interest free or low interest loan is provided by an insurer to an employee of an insurance agent under an arrangement between the insurer and the insurance agent, the benefit arising from the loan is a fringe benefit and a liability under the FBTAA may arise for the insurance agent.

Date of effect

4. This Ruling applies to income tax and fringe benefits tax years in the manner set out in paragraphs 29-31 below. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Explanations

Definitions

5. In this Ruling:

- an 'insurer' is an insurance company that enters into contracts of insurance;
- an 'insurance agent' may be a natural or a company and may receive commission as a sole trader, as a partner in a partnership or as a trustee of a trust estate; and
- an 'employee of an insurance agent' is a natural person who is employed by an insurance agent. Some employees of an insurance agent may have formerly been insurance agents themselves.

Background

6. Insurance policies are contracts entered into between an insurer and a policyholder. Insurers rely on their network of insurance agents to introduce insurance business and to 'service' existing policyholders with a view to maintaining the insurer/policyholder relationship. Agents receive a commission in respect of each policy that the agent introduces. In some cases the commission is paid over a period of years and having regard to the continued existence of the policy. Commission is also payable on renewal of non-continuous policies.

7. A strong network of insurance agents is vital to an insurer's continued success. The industry is very competitive and insurers are prepared to provide a number of benefits to their insurance agents or their agent's employees, including making loans at less than market rates of interest. These loans may be used for private purposes.

8. A loan may be made by an insurer directly to an insurance agent who carries on business as a sole trader, as a trustee or in partnership. An insurer may also provide a loan directly to an employee of the agent or a loan may be made to the agent which then on-lends the funds to its employee.

Insurers and Fringe Benefits Tax

9. Employers ordinarily have a liability for fringe benefits tax in respect of benefits conferred on employees if the benefits are provided in respect of that employment. Whether an individual agent is an employee of an insurer was considered in Taxation Ruling IT 2511. That Ruling discusses the general question of whether or not tax instalment deductions are required to be made from commission income paid to insurance agents. Since the issue of IT 2511 in December 1988, we have generally accepted that commissions received by insurance agents are not 'salary and wages' within the meaning of that term in section 221A of the ITAA. That being so, insurance agents are not employees for the purposes of Division 2 of Part VI of the ITAA or for the purposes of the FBTAA.

10. Some insurance agents and employees of insurance agents have suggested that they were, in fact, employee agents of insurers at the time existing loan arrangements were entered into. As such, they argue that they are former employees still in receipt of a benefit provided in respect of that employment - a situation which may create a fringe benefits tax liability for the insurer because the definition of 'employee' in subsection 136(1) of the FBTAA includes former employees.

11. The reference in the definition to a 'former employee' ensures that a benefit provided in respect of employment activities does not escape fringe benefits tax merely by virtue of the fact that it is given after the employment ceases: see the discussion in paragraph 10 of Taxation Ruling MT 2016. The key point is, however, that the benefit must be provided 'in respect of the employment of the employee'.

12. Irrespective of the basis on which loans may or may not have been originally provided, we understand that the reason for the continued existence of the loans is not because of any former relationship between the agent and insurer. They remain in place because of the existence of a current business relationship, i.e., if the relevant individual ceased to be an insurance agent or he or she ceased to be employed by an insurance agent, the loan would either be terminated or a market rate of interest would thereafter apply.

13. In view of the above, we do not accept that a fringe benefits tax liability is created for an insurer who provides an interest free or low interest loan to an insurance agent or to an employee of an insurance agent.

Employees of insurance agents

14. Interest free or low interest loans to employees of insurance agents are provided irrespective of whether the borrower was formerly an agent of the insurer. If the insurance agent itself makes the loan a fringe benefits tax liability may arise for that agent in the same way as it would for any employer.

15. In a number of cases, however, the loans were made when the employee was previously an agent of the insurer in his or her own right and the loan continues because of an arrangement between the insurer and the new employer (being the continued employment of the former agent). Alternatively, loans are made after the borrower becomes an employee of the insurance agent but still pursuant to an arrangement between the insurer and the insurance agent. In these cases the loan agreement remains in place or the new loan is made because of the employee's employment with the agent. If that employment ceased the insurer would call up the loan or, again, it may continue but at market rates of interest.

16. In these cases a fringe benefits tax liability may arise for the insurance agent. The definition of 'fringe benefit' includes a benefit provided to an employee by a person ('the arranger') other than the employer under an arrangement between the employer and the arranger in respect of the employment of the employee. The arrangement flows from the agency agreement between the insurer and the insurance agent. As indicated above, the low interest loan is provided in respect of the current employment of the employee. 'In respect of ', in relation to the employment of an employee includes by reason of, by virtue of, or for or in relation directly or indirectly to, that employment: see subsection 136(1) of the FBTAA.

17. The benefit provided in these cases is a loan fringe benefit. The taxable value of a loan fringe benefit is defined in section 18 of the FBTAA and is, broadly, the amount by which the notional amount of interest in relation to the loan in respect of the year of tax exceeds the amount of interest that has accrued on the loan in respect of the year of tax. The 'notional amount of interest' is defined in subsection 136(1) of the FBTAA and is, broadly, the amount of interest that would have accrued on the loan in respect of the year of tax at the appropriate statutory interest rate.

18. The relevant rates of interest are:

Year ending 31 March	Rate of Interest
1993	9.25%
1992	13.50%
1991	14.90%
1990	14.25%

19. Where loan funds are used partly for income producing purposes and partly for private purposes the taxable value of the loan fringe benefit may be reduced under section 19 of the FBTAA. The taxable value may be reduced to the extent to which the interest payable on the loan is, or would have been, allowable as a once-only income tax deduction to the employee. Special rules apply in respect of loans to employees that are used to purchase a car which is used for business purposes.

20. Taxation Ruling MT 2019 deals with the application of the fringe benefits tax to benefits provided by a family private company to a shareholder of the company who is also a past or current employee of the company or an associate of such an employee. As a general rule, where there are no facts or circumstances which positively indicate that a loan to a shareholder/employee is associated with that person's employment and the loan is consistent with his or her status as a shareholder, it would ordinarily be inferred that the loan was made by virtue of the shareholding. In such cases no fringe benefits tax liability will arise because the benefit is not provided in respect of the employment of the employee. However, questions as to the application of section 108 of the ITAA may arise where amounts paid as loans, advances or other payments for the benefit of shareholders of a private company could be deemed to be dividends paid to the shareholders.

21. In most cases the principal employees of insurance agents that are companies are also shareholders in the company. These employees normally receive interest free or low interest loans. We understand that entitlement to a loan and the amount available to be borrowed depends, to some extent, on the volume of business introduced by the agent. Incorporated agencies necessarily employ individuals in that activity. Accordingly, the provision of a loan to these employees is directly linked to their employment activities. In such circumstances it is difficult not to make the positive connection

between the provision of the loan and the employment activities of the borrowers mentioned above in paragraph 20.

Insurance agents: non-employees

22. The benefit received by an insurance agent from an interest free or low interest loan provided by an insurer is not a fringe benefit for the purposes of the FBTAA. However, the benefit may be a non-cash business benefit within the meaning of that term in section 21A of the ITAA.

23. In *F C of T v. Cooke & Sherden* 80 ATC 4140; (1980) 10 ATR 696, the gratuitous provision of a benefit in the form of a holiday by a soft drink manufacturer to retailers of its product did not, of itself, preclude its characterisation as the 'proceeds of a business' within the definition of 'income from personal exertion' in subsection 6(1) of the ITAA. If the benefit could be so characterised it is clear that it would be income in the hands of the recipient. As Windeyer J said in *Scott v. F C of T* (1966) 117 CLR 514 at p. 524, the definition of 'income from personal exertion' in subsection 6(1) of the ITAA:

> 'does not I think bring anything into charge as income. It refers to what is already by its nature income...'

24. In *Cooke & Sherden,* however, the Full Federal Court took the view that as the benefit conferred on the retailers was not 'convertible into money or money's worth, there was no receipt of income according to ordinary concepts...' See 80 ATC at p. 4150; 10 ATR at p. 706. Similarly, the benefit of the interest free or low interest loans here in question, not being convertible into money or money's worth, could not be said to be income according to ordinary concepts notwithstanding that it may be characterised as the proceeds of a business.

25. As a result of the decision in *Cooke & Sherden* section 21A was enacted. It provides that non-cash benefits received from business relationships that are not convertible into cash are treated as if they were convertible to cash and brings within the assessable income non-cash business benefits, whether convertible or not, provided they are of an income nature. That is, it provides the missing characteristic that would otherwise make the benefit an income receipt. The section applies to non-cash business benefits provided after 31 August 1988. Accordingly, the section applies to benefits received under arrangements that may have been entered into before 31 August 1988, whether on a contractual basis or not, where the benefit is provided after that date.

26. 'Non-cash business benefit' is defined to mean property or services provided after 31 August 1988 wholly or partly in respect of a business relationship or wholly or partly for or in relation directly or indirectly to a business relationship. 'Services' is defined to include any benefit provided under an arrangement for or in relation to the lending of money. Insurers and insurance agents have a business relationship. The loan is provided because of that relationship and the rate of interest, being less than market rates, creates a benefit for the agent in the commonly understood meaning of that word. Accordingly, the provision of an interest free or low interest loan by an insurer to an agent of the insurer constitutes a non-cash business benefit for the purposes of section 21A of the ITAA.

27. Subsection 21A(2) requires any non-cash business benefit that is income derived by a taxpayer to be brought into account at its arm's length value, reduced by the recipient's contribution (if any). In the cases at hand, the amount to be brought into account is the difference between the amount of interest the agent could reasonably be expected to pay on the loan if the arrangement was at arm's length and the amount of interest which has actually been paid. For the purpose of determining an 'arm's length value', a value calculated with reference to the statutory interest rate used for the purposes of the FBTAA will be accepted. See paragraph 18 above.

28. The income amount calculated under subsection 21A(2) may be reduced if, had the recipient incurred and paid an amount in respect of the provision of the benefit, the recipient would have been entitled to a 'once-only deduction' for the expenditure. The reduced amount will be the difference between the amount calculated under subsection 21A(2) and the otherwise deductible amount of the expenditure had it been incurred by the taxpayer.

Additional tax

29. Recent audit activity indicates that there is a degree of non-compliance within the insurance industry in respect of the issues discussed in this ruling. An industry-wide program has commenced in order to remedy this position. An integral part of that program is encouraging voluntary disclosures by taxpayers of situations that do not reflect the application of the law as set out in this ruling.

30. Paragraphs 21-30 of Taxation Ruling IT 2517 set out guidelines for the remission of additional tax for incorrect income tax returns in cases where a voluntary disclosure has been made by a taxpayer. The guidelines are provided to assist officers in the exercise of the discretion to remit additional tax. They are not intended to lay down any conditions that restrict Deputy Commissioners and authorised officers in the exercise of the discretion to remit additional tax.

31. Consistent with those guidelines, taxpayers who make a voluntary disclosure could expect a remission of additional income tax or fringe benefits tax to an amount equal to 10% per annum of the tax avoided, subject to a maximum of 50% of the tax avoided in any year. For those taxpayers who make a voluntary disclosure within three months of the issue date of this ruling assessments or amended assessments will be raised only in respect of the 1990 and subsequent income tax and fringe benefits tax years.

Examples

(a) Loan provided to insurance agent

32. On 1 July 1992 Tom Jones, a self-employed insurance agent, received a 10 year interest free loan of $100,000. Tom has used the loan to purchase a home for $50,000 and expended $50,000 developing his agency business. The non-cash business benefit resulting from the loan is income derived by Tom. However, as interest on a loan used to develop his agency business would be deductible under subsection 51(1) of the ITAA if Tom had incurred the expenditure for that purpose, the 'otherwise deductible rule' in subsection 21A(3) will apply. For the purposes of determining an arm's length value assume the statutory interest rate is 10% and the total interest expense would have been $10,000 in the first year.

33. In these circumstances, the amount assessable to Tom Jones for the year ended 30 June 1993 is $5,000 calculated as follows:-

Total benefit:		$10,000
less: deductible percentage (50%)	$ 5,000	
Assessable amount:		$ 5,000

(b) Loan provided to employee of insurance agent

34. John Smith is an employee of John Smith Insurance Pty Ltd. The company is an insurance agent for X Insurance Co Ltd. X Insurance Co Ltd provides an interest free loan of $100,000 to John Smith which he uses to purchase a private residence. The loan is provided on the basis that John Smith Insurance Pty Ltd continues to employ John Smith.

35. In these circumstances the benefit is provided under an arrangement between X Insurance Co Ltd and John Smith Insurance Pty Ltd as the employer of the recipient. John Smith Pty Ltd is subject to FBT on the taxable value of the loan fringe benefit.

Commissioner of Taxation

11 November 1993

ISSN 1039 - 0731

ATO references
NO
BO NOR: J36/354/2

Previously released in draft form as TR 93/D31

Price $0.90

FOI index detail
reference number
I 1014028

subject references
- fringe benefits
- insurance agents
- low interest loans
- non-cash business benefits

legislative references
- ITAA 21A
- ITAA 25(1)
- ITAA 51(1)
- ITAA 221A
- FBTAA 18
- FBTAA 19
- FBTAA 136(1)

case references
- F C of T v. Cooke & Sherden 80 ATC 4140; (1980) 10 ATR 696
- Scott v. F C of T (1966) 117 CLR 514