TR 93/D31 - Income tax and fringe benefits tax: taxation consequences of insurance companies providing interest free or low interest loans to insurance agents or their employees

This document has been finalised by TR 93/38.

Draft 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

contents para

Draft Taxation Rulings (DTRs) represent the preliminary, though considered, views of the Australian Taxation Office.

DTRs may not be relied on by taxation officers, taxpayers and practitioners. It is only final Taxation Rulings which represent authoritative statements by the Australian Taxation Office of its stance on the particular matters covered in the Ruling.

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 not used for income producing 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 Act 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 arises for the insurance agent.

Date of effect

4. This Ruling applies to years commencing both before and after its date of issue. 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

5. In this Ruling:

- an "insurer" is an insurance company that enters into contracts of insurance;
- an "insurance agent" may be a natural person who receives commission as a sole trader, as a person in the capacity of a partner in a partnership or as a trustee of a trust estate. A company may also be an insurance agent; 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 carried on an insurance agency business themselves.

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. An insurance agent may be a natural person who receives commission as a sole trader, as a person in the capacity of a partner in a partnership or as a trustee of a trust estate. A company may also be an insurance agent. Some insurers require agent companies to retain the services of a certain individual or individuals who are known by and acceptable to the insurer. The efficacy of these arrangements for taxation purposes was discussed in Taxation Ruling IT 2121.

8. 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. Representations have been made to this office concerning the taxation consequences of the provision of interest free or low interest loans to insurance agents or their employees that are used for private purposes.

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. The ATO has accepted that commissions received by insurance agents are not "salary and wages" within the meaning of that term in section 221A of the ITAA. Insurance agents are therefore not employees of insurers for the purposes of Division 2 of Part VI of the ITAA or for the purposes of the FBTAA. (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).

10. Some 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 - 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. This argument is not accepted. As indicated above, the benefit must be provided "in respect of the employment of the employee". Irrespective of the basis on which loans may or may not have been originally provided, this Office understands that the reason for the continued existence of the loans is not because of any former relationship between the agent and insurer.

12. They continue on foot 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 be terminated. For example, if an agent decided to terminate an agency agreement and to commence an agency business with another insurer, any outstanding loan balance would be called up. In other cases the loan may be allowed to continue but at market rates of interest.

Employees of Insurance Agents

13. In some cases low interest loans are provided to employees of insurance agents 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 arises for that agent in the same way as it would for any employer.

14. More often, however, the loans were made when the employee was previously an agent of the insurer in his or her own right and continues because of an arrangement between the insurer and the new employer (being the continued employment of the employee). 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 continues on foot 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.

15. In these kinds of cases a fringe benefits tax liability is created 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. As indicated above the low interest loan is provided in respect of the 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.

Insurance Agents: Non-Employees

16. If an insurer provides a low interest loan to an insurance agent and the agent is carrying on an insurance agency business then no fringe benefits tax liability arises as the loan is not provided because of any employment relationship but, rather, because of a business relationship between the insurer and the agent.

17. In *F.C. of T. v. Cooke & Sherden* (1980) 80 ATC 4140; 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.....".

18. In *Cooke & Sherden* however, the Full Federal Court took the view that as the benefit conferred on the retailers was not "convertible to money or money's worth, there was no receipt of income according to ordinary concepts.....". See 80 ATC at p. 4150. 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.

19. 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.

20. The provision of a interest free or low interest loan by an insurer to an agent of the insurer constitutes a non-cash business benefit within the meaning of that term in section 21A of the ITAA.

"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.

21. It is clear that the insurer and agent have a business relationship, that 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.

22. As indicated above, subsection 21A(2) requires any non-cash business benefit that is income derived by a taxpayer to be brought into account at its arms length value, reduced by the recipients 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 arms length and the amount of interest which has actually been paid. For the purpose of determining an 'arms length value' a value

calculated with reference to the benchmark interest rate defined in subsection 136(1) of the FBTAA will be accepted.

23. 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.

Examples

24. **(a) Loan provided to self employed agent**

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 arms length value assume the benchmark rate is 10% and the total interest expense would have been $10,000 in the first year.

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	$ 5,000
Assessable amount:	$ 5,000

(b) Loan provided to employee of agent

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 have a business relationship with X Insurance Co Ltd and continues to employ John Smith.

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 benefit.

Commissioner of Taxation

22 July 1993

ISSN 1039 - 0731

ATO references
NO
BO cnn/stc/93-2

Not previously released to the public in draft form

Price $0.60

FOI index detail
reference number

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

legislative references
- ITAA 21A
- ITAA 25(1)
- FBTAA 136(1)

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