IT 2276 - Income tax : assessability of profits on sales of investments of general insurance companies

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TAXATION RULING NO. IT 2276

INCOME TAX : ASSESSABILITY OF PROFITS ON SALES OF INVESTMENTS OF GENERAL INSURANCE COMPANIES

F.O.I. EMBARGO: May be released

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REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1077799	ASSESSABLE INCOME: PROFITS ON SALES OF INVESTMENTS OF GENERAL INSURANCE COMPANIES GENERAL INSURANCE COMPANIES - PROFITS ON SALES OF INVESTMENTS	25(1)

PREAMBLE This ruling deals with the liability to income tax of profits and losses made by general insurance companies on realization of investments. The ruling extends to situations where a general insurance company maintains its investments in more than one fund and where the realizations are made by a subsidiary of a general insurance company. It does not extend to profits assessable under section 26AAA.

2. The assessability of profits derived by a general insurance company from realization of investments was considered by Brooking J. in the Supreme Court of Victoria in The Chamber of Manufactures Insurance Ltd v FC of T 83 ATC 4773; 15 ATR 68. The company's activities covered a wide range of insurance including fire, marine, loss of profits, plate-glass, burglary and workers' compensation insurance. Nearly three-quarters of its business was workers' compensation insurance.

3. Brooking J. saw the question as being resolved by the decision of the High Court in The Colonial Mutual Life Assurance Society Ltd v FC of T (1946) 73 CLR 604 and the authorities referred to therein. In that case the Court expressed the view that profits and losses on the realization of investments of the funds of an insurance company should usually be taken into account in the determination of the profits and gains of the business. The reason for this view lay in the acceptance by the Court that investment of the funds of an insurance company is just as much a part of its business as the collection of premiums and that the acquisition and realization of investments to secure the most effective yield is a normal step in carrying on an insurance business.

4. Although the decision of the High Court related to a business of life assurance Brooking J. concluded that the

decision of the High Court applied with equal force to the business of insurance generally. He recognized that there may be situations where the surplus on realization of an investment would not constitute part of an insurance company's income producing activities but none of the investments in issue fell into that category. In the result he concluded that the profits were liable to income tax.

5. The Federal Court upheld the conclusion of Brooking J. see 84 ATC 4315 : 15 ATR 599. The Federal Court agreed that the decision of the High Court in the Colonial Mutual case was expressed in terms which would cover all insurance companies and it went on to say that the decision of the High Court does not deny that in some cases profits and gains on the realization of an investment of the funds of an insurance company should not be taken into account in determining the profits and gains of the business. As examples of profits on sales of investments to which the decision of the High Court would not apply the Court referred to profit on the sale of a head office building and profits arising from an investment fund unrelated to the insurance activity.

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6. As a general rule profits and losses on the realization of investments of the funds of general insurance companies should be taken into account in ascertaining the taxable income of the companies. In the light of the decisions of the various Courts, and the reasons for the decisions, the onus on general insurance companies which seek to establish that profits and losses in realization of investments should not be taken into account for income tax purposes is a heavy one.

7. Notwithstanding the general rule it has long been accepted, and the Courts recognize, that, where a building used solely as the head office for an insurance company's business is sold at a profit and there are no special circumstances associated with the transaction, the profit should be accepted as a capital profit and not part of the company's assessable income. A similar view would be taken in respect of a profit arising from the sale of any building other than a head office if the facts showed that it was a building used solely by the company as a permanent place in which the insurance company conducted its business.

8. Sometimes buildings acquired by insurance companies, including head office, are used for dual purposes. Part of the building may be used as the insurance company's fixed place of business and the remainder of the building is used to derive rental incomes. It has been usual in such cases to apportion profit from the sale of such a building on the basis of the floor-space allotted to each activity. That long-standing practice should continue. In some circumstances, for example, where it can be adequately demonstrated that floors have materially different values, some suitable modification of the floor-space basis should, as in the past, be adopted.

9. Where a general insurance company claims to maintain an investment fund separate from its insurance business the claim

will require careful consideration. It should be noted immediately that the Federal Court placed a substantial qualification on the existence of a separate investment fund, i.e. such a fund would be recognized only where the reserve fund was demonstrably sufficient to meet claims and expenses in all reasonably foreseeable contingencies.

10. The funds of an insurance business are generally invested in a variety of ways. Some investments provide for short term liquidity needs while others may be of a longer term nature to protect against eventualities some of which, quite commonly, an insurance company hopes will not occur. Nevertheless, the investments are usually related to the insurance risks or insurance business. The circumstances may be very rare where a general insurance company can successfully demonstrate the existence of an investment fund separate from and unrelated to its insurance business.

11. Matters that would need to be taken into account include the investment history and policy of the company, the manner in which the investments have been brought to account and reported, the overall performance and profitability of the company, the source of funds used to acquire the investments and whether the reserve fund is demonstrably sufficient to meet claims and expenses in all reasonably foreseeable contingencies. For an investment fund to be separate from the insurance business is not merely a question of book-keeping or accountancy - the fund, by its very nature, must be seen to be separate from the insurance business.

12. Where the existence of an investment fund separate from and unrelated to the insurance business is accepted, it does not automatically follow that the profits and losses on realization of investments in the investment fund should not be taken into account in arriving at the taxable income. As the Federal Court decision illustrates, it would depend upon the application of the factors to which reference was made in London Australia Investment Co. Ltd v FC of T (1977) 138 CLR 106.

13. It is understood that some general insurance companies have established separate investment companies and investment trusts to remove profits arising from sales of investments from the implications of the decision in the Chamber of Manufactures case. It is not accepted that the mere shifting of the investment activity of an insurance company into a subsidiary company achieves the result that profits and losses on realization of investments are not taken into account in calculating the taxable income of the subsidiary company or the net income of the trust. There is nothing in the various decisions of the Courts to suggest that this ought to be so. Consequently, profits and losses on realization of investments should be included in the calculation of the taxable income of the subsidiary company or the net income of the trust. Whether any particular transaction or transactions ought not to be so treated will depend upon consideration of matters referred to in earlier paragraphs of this Ruling.

COMMISSIONER OF TAXATION
29 March 1986

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