

# **IRAS e-Tax Guide**

## **Income Tax: Tax Treatment of Gains Derived from the Disposal of Investments of Insurers**



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# **Tax Treatment of Gains Derived from the Disposal of Investments of Insurers**

## **1 Aim**

- 1.1 This e-Tax Guide sets out how the Comptroller of Income Tax (“CIT”) applies the principles enunciated in the case of Comptroller of Income Tax v BBO [2014] SGCA 10 (“BBO”) to determine the tax treatment of gains derived from the disposal of investments of insurers.
- 1.2 It is relevant to a person (including a partnership) licensed under the Insurance Act to carry on insurance business in Singapore (“insurer”).

## **2 At a glance**

- 2.1 Insurance is an arrangement that protects someone from incurring future losses, as from damage, theft, illness, or death. It is an arrangement that transfers the risk of a specified loss to the insurer in exchange for the payment of a premium. The business model of an insurer involves the collection of premiums and channeling such premium receipts into productive uses such as investment in equity and debt securities and properties which would generate investment returns, including dividends, interest, rental and gains from disposal of investments. The premiums collected and the investment returns would be used to meet claims made or to be made by policyholders.
- 2.2 As the investment activities are an integral part of the insurance business of an insurer, the CIT has taken the view that all investments of an insurer are revenue assets. Hence, all investment returns of the insurance business, including dividends, interest, rental and gains from disposal of investments of an insurer are revenue in nature and thus taxable.
- 2.3 In the BBO case, the Singapore Court of Appeal (“the Court”) ruled that insurers, in addition to holding investments as revenue assets, can also hold investments as capital assets under exceptional circumstances. Arising from the decision in the BBO case, this guide provides the approach that the CIT takes to determine the tax treatment of gains derived from the disposal of investments of insurers.

## **3 Background on the BBO case**

- 3.1 The Court issued its decision in the BBO case on 4 February 2014. The case concerns the taxability of gains arising from a general insurer’s disposal of shares in related companies within a Group pursuant to a corporate takeover exercise. The taxpayer had argued that the shares were held as capital assets for corporate preservation and hence the gains on disposal of the shares were capital in nature. On the other hand, the CIT had taken the position that the shares were revenue assets of the insurance business and sought to tax the gains on disposal as income arising from the general insurer’s business.

- 3.2 The Court recognised that as a matter of practicality, the nature of insurance (or similar) businesses would ordinarily give rise to an inference that the gains concerned arose in the course of trade or in the operation of business in carrying out a scheme for profit-making, unless there was cogent evidence that the investments were acquired and held as capital assets.
- 3.3 In the BBO case, the Court relied heavily on the motive of corporate preservation behind the acquisition of the shares which gave rise to a strong inference that the shares were capital assets. This motive was supported by the following cogent evidence that were specific to the case:
- (i) the numerous cross-holdings of shares and cross-directorships among companies within the Group;
  - (ii) regular updates on status of cross-holdings of companies in the Group were generated to the senior management;
  - (iii) any decision to sell any shares or rights in the companies within the Group was closely scrutinized and reviewed by the Investment Committee of the Group to ensure that the appropriate level of shareholding and effective control was maintained;
  - (iv) the taxpayer was not allowed to sell any of its shares and rights in relation to companies with the Group without requisite approval from holding company; and
  - (v) the shares were treated differently and segregated from shares that were readily traded.
- 3.4 The Court also considered other factors such as the duration of ownership, frequency of disposal as well as circumstances leading to the disposal of investments which supported the taxpayer's claim that the investments were acquired for corporate preservation purposes.

#### **4 CIT's application of the principles in the BBO case**

- 4.1 Following closely to the principles in the BBO case, the CIT will continue to treat the investments of insurers as their revenue assets and tax the gains on disposal of these investments as trade income under section 10(1)(a) of the Income Tax Act (ITA). Any investment income derived from the investments prior to disposal (e.g. dividends, interest or rental) is also taxable as trade income under section 10(1)(a) of the ITA.
- 4.2 As investment activities are an integral part of the insurance business due to the insurer's business model as explained in paragraph 2.1

above, the CIT expects the bulk of the insurer's investments to be revenue in nature.

#### Investments in ordinary shares (whether quoted or unquoted)

- 4.3 Where insurers claim that certain investments in ordinary shares are capital assets, they must be able to provide cogent and contemporaneous evidence to substantiate that the motive of acquiring, holding and disposing the investments is not related to or for the insurance business of the insurer. The insurers have to produce documentation such as directors' resolution, minutes of board/directors' meetings, minutes of investment committee meetings and announcements to shareholders that provide explanation on:
- (i) the purpose of acquiring the investments and reasons for disposal;
  - (ii) the factors considered and the process of decision-making with regards to the acquisition, holding and disposal of the investments; and
  - (iii) internal, management or external restrictions imposed on the disposal of the investments.
- 4.4 In addition, the period of holding the investments, the frequency of transactions surrounding the investments and the nexus between the disposal of the investments and the carrying on of the insurance business must bear out the insurer's original intention of acquiring and holding the investments as capital assets.

#### Investments in immovable properties

- 4.5 Although shares were the subject of dispute in the BBO case, the CIT is prepared to treat the following immovable properties as capital assets of the insurance business:
- (i) immovable properties which are consistently and substantially occupied and used by the insurers' own employees as office premises (excludes premises occupied by employees of related companies and insurance agents). This is to recognize that insurers may conduct their business from buildings which are owned by them.
  - (ii) immovable properties which are consistently and substantially used by the insurers as staff accommodation (staff excludes employees of related companies in the Group) provided these benefits-in-kind are declared in the hands of the insurer's employees.
- 4.6 Any gain or loss from the disposal of the immovable properties in paragraph 4.5 above will accordingly be treated as capital in nature.

- 4.7 For all other immovable properties, as with investments in ordinary shares, the insurers must be able to provide cogent and contemporaneous evidence as specified in paragraph 4.3 to substantiate that the motive of acquiring, holding and disposing the immovable properties is not related to or for the insurance business of the insurer.

#### Investments in any other assets

- 4.8 As with investments in ordinary shares, where insurers claim that certain investments in any other assets are capital assets, they must be able to provide cogent and contemporaneous evidence as specified in paragraph 4.3 to substantiate that the motive of acquiring, holding and disposing such investments is not related to or for the insurance business of the insurer.

### **5 Administrative procedure**

- 5.1 In the interest of tax certainty, insurers can identify their capital assets for the tax treatment to be determined by the CIT prior to disposal. This practice is not new and has been made available to taxpayers who have adopted FRS 39 tax treatment as well as property developers<sup>1</sup>.

#### Existing investments that are held by insurers

- 5.2 Insurers that continue to hold investment in ordinary shares, immovable properties and any other assets and claim these assets are not related to or for the insurance business have to identify such investments and inform the CIT at the point of filing the Year of Assessment 2016 tax return or any time earlier. The identification of investments as capital assets must be supported with detailed submission and cogent and contemporaneous evidence as specified in paragraph 4.3.
- 5.3 By and large, the CIT expects insurers to produce cogent and contemporaneous evidence to support their submission. This is no different from what is expected from all other taxpayers. However, there may be cases where insurers are unable to comply as they had not maintained proper documentation in the past. Depending on the circumstance of each case, the CIT may accept detailed submission (including the insurers' written explanation) with partial documentary evidence.
- 5.4 The CIT will review the information submitted pursuant to paragraph 5.2 or 5.3 and inform the insurers whether he agrees or disagrees that the identified investments can be treated as capital assets. This is so

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<sup>1</sup> Refer to IRAS E-Tax Guide on "Income Tax Implications Arising From The Adoption of FRS 39 – Financial Instruments: Recognition & Measurement" and "Income Tax: Taxation of Property Developers".

that the appropriate tax treatment can be applied on items relating to such investments henceforth.

- 5.5 Insurers have to henceforth keep cogent and contemporaneous evidence to complement whatever evidence they have already submitted to the CIT. Such evidence must be kept so long as the capital assets have not been disposed of. This means that the retention of evidence may be for periods longer than the statutory record keeping period<sup>2</sup>.
- 5.6 The CIT is not precluded from reversing the position taken if subsequent evidence conflicts with the capital treatment that has been accorded and applied. When the treatment is reversed from capital to revenue, consequential tax adjustment as shown in the example below may apply.

**Example<sup>3</sup>**

Prior to disposal		At disposal	
Capital	Unrealised loss due to FRS39 tax treatment <sup>4</sup> and foreign exchange upon revaluation that are recognised in the profit and loss account would have been treated as non-deductible.	Revenue	To avoid re-opening of back Years of Assessment, we will use historical cost to compute actual gain/loss on disposal. Taxpayers will have to track the historical cost of the investment.
	Unrealised gain due to FRS39 tax treatment <sup>4</sup> and foreign exchange upon revaluation that are recognised in the profit and loss account would have been treated as non-taxable.		

New investments acquired by insurers

- 5.7 Where insurers claim that their new investments are capital assets, they have to enclose detailed submissions and cogent and contemporaneous evidence as specified in paragraph 4.3 in their tax returns for the Years of Assessment in which the investments are acquired.

<sup>2</sup> Under the Income Tax Act, businesses are required to keep their business records and accounts for a period of at least five years effective 1 January 2007.

<sup>3</sup> This is for illustration only and is not meant to be exhaustive.

<sup>4</sup> Provided that these are financial instruments classified as either “Held for Trading” or designated at “Fair Value through profit and loss account” under FRS39. This tax adjustment is irrelevant for financial instruments classified as “Available for Sale” under FRS39 as any unrealised gain or loss (with the exception of impairment loss) resulting from fair valuation goes to equity reserves in the balance sheet instead of the profit and loss account.



5.8 The same approach outlined in paragraphs 5.4 to 5.6 will similarly apply to this category of investments.

## **6 Effective date**

6.1 The above administrative procedure takes immediate effect from the date of this e-Tax Guide.

## **7 Contact information**

7.1 If you wish to seek clarification on the contents of this e-Tax Guide, please call 1800-3568622 (Corporate Tax Division).