Note (not part of Rulings): The issues dealt with by these Rulings were first covered in Public Ruling BR Pub 96/9A, published in *Tax Information Bulletin* Volume 8, Number 8 (November 1996). The arrangements became the subject of two separate rulings. The taxation of commissions issue was covered in BR Pub 00/01 and the fringe benefit issue in BR Pub 00/02. BR Pub 00/01 and BR Pub 00/02, published in *Tax Information Bulletin* Volume 12, Number 4 (April 2000), expired on 31 December 2004.

COMMISSIONS RECEIVED BY LIFE AGENTS ON THEIR OWN POLICIES AND THOSE OF ASSOCIATED PERSONS – INCOME IMPLICATIONS

PUBLIC RULING – BR Pub 10/07

This is a Public Ruling made under section 91D of the Tax Administration Act 1994.

Taxation Laws

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

This Ruling applies in respect of sections CB 1 and CE 1.

The Arrangement to which this Ruling applies

The Arrangement is the provision of a life insurance policy by a life insurer to a life agent or persons associated with the life agent. The life agent either:

- receives commissions on those policies; or
- sets off commissions on those policies against premiums payable on the life agent's own life policy or those of associated persons.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- Commissions received by a life agent on the life agent's own life policy or policies of persons associated with the life agent are income under section CB 1 (if the life agent is an independent contractor) and section CE 1 (if the life agent is an employee).
- When a life agent sets off commissions against premiums payable on these policies, the amount of commission set off is income under section CB 1 or CE 1.

The period for which this Ruling applies

This Ruling will apply for an indefinite period beginning on the first day of the 2008/09 income year.

This Ruling is signed by me on the 29th day of April 2010.

Susan Price
Director, Public Rulings

DISCOUNTED PREMIUMS ON LIFE INSURANCE POLICIES PROVIDED TO LIFE AGENTS AND ASSOCIATED PERSONS – FRINGE BENEFIT TAX IMPLICATIONS

PUBLIC RULING – BR Pub 10/08

This is a Public Ruling made under section 91D of the Tax Administration Act 1994.

Taxation Law

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

This Ruling applies in respect of section CX 2.

The Arrangement to which this Ruling applies

The Arrangement is the provision of a life insurance policy by a life insurer to a life agent or persons associated with the life agent in return for discounted premiums.

How the Taxation Law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

- When a life agent or persons associated with the life agent receive discounted premiums on a life insurance policy from the life agent's employer, the policy will be a fringe benefit under section CX 2 if it is provided in connection with the life agent's employment. The life insurer will be liable for fringe benefit tax (FBT) on the taxable value of the benefit.

The period for which this Ruling applies

This Ruling will apply for an indefinite period beginning on the first day of the 2008/09 income year.

This Ruling is signed by me on the 29th day of April 2010.

Susan Price
Director, Public Rulings

COMMENTARY ON PUBLIC RULINGS BR Pub 10/07 and BR Pub 10/08

This commentary is not a legally binding statement, but provides assistance in understanding and applying the conclusions reached in Public Rulings BR Pub 10/07 and BR Pub 10/08.

All references are to the Income Tax Act 2007 unless otherwise stated.

Summary

These Rulings and commentary are about situations where life agents sell life insurance policies to themselves or persons associated with them. The issues that the Rulings and commentary are particularly concerned with are as follows:

- Which arrangements are subject to income tax and which are subject to fringe benefit tax;
- Whether commissions received by agents on their own life insurance policies are amounts received from trading with themselves and so are not income;
- Whether income is received when the agent does not directly receive commissions and they are instead set off against premiums they are obliged to pay on their own life insurance policies;
- Whether a life insurer will be liable for FBT when it provides a life insurance policy to a life agent at a discount.

The Rulings conclude:

- Commissions received by life agents on their own policies, or policies of persons associated with the life agent, are income.
- When a life agent sets off a commission against premiums due on a life insurance policy purchased from their employer, the amount of commission is income.
- Life agents, who agree that no commission entitlement will arise on their own policies or policies of associated persons, are not assessable on any notional commission; that is, the amount of commission that would have been received. When a life agent agrees that no commission entitlement will arise, no income comes in.
- A life insurer will be liable for FBT when the life insurer provides a life insurance policy at a discount to a life agent or persons associated with the life agent and that policy is provided in connection with the life agent's employment. The life insurer will be liable for FBT on the taxable value of the benefit.

Background

The subject matter covered in these Rulings was previously dealt with by BR Pub 96/9A published in *Tax Information Bulletin* Volume 8, Number 8 (November 1996), page 6. Public Ruling BR Pub 96/9A dealt with the income tax and fringe benefit consequences when life agents take out life policies on their own lives and those of their families. That Ruling expired on 31 December 1999. The arrangements covered by BR Pub 96/9A became the subject of two separate rulings. The taxation of commissions issue was covered in BR Pub 00/01 and the fringe benefit issue in BR Pub 00/02. A single commentary accompanied both Rulings. BR Pub 00/01 and BR Pub 00/02 expired on 31 December 2004.

The Commissioner is satisfied that the conclusions in BR Pub 00/01 are correct. BR Pub 00/02 and the commentary to the Rulings required minor adjustments to reflect the Commissioner's view that for the purposes of FBT, "benefit" refers to the provision of a life insurance policy in connection with the employment relationship (and not the amount of the discounted premiums). Both Rulings have also been updated for the 2007 Act.

Legislation

Section CB 1 states:

> **Amounts derived from business**
>
> *Income*
>
> (1) An amount that a person derives from a business is income of the person.
>
> *Exclusion*
>
> (2) Subsection (1) does not apply to an amount that is of a capital nature.

Section CE 1 states:

> **Amounts derived in connection with employment**
>
> The following amounts derived by a person in connection with their employment or service are income of the person:
>
> (a) salary or wages or an allowance, bonus, extra pay, or gratuity:
>
> (b) expenditure on account of an employee that is expenditure on account of the person:
>
> (c) the market value of board that the person receives in connection with their employment or service:
>
> (d) a benefit received under a share purchase agreement:
>
> (e) directors' fees:
>
> (f) compensation for loss of employment or service:
>
> (g) any other benefit in money.

Section CX 2 defines "fringe benefit" as:

> **Meaning of fringe benefit**
>
> *Meaning*
>
> (1) A fringe benefit is a benefit that—
>
> (a) is provided by an employer to an employee in connection with their employment; and
>
> (b) either—
>
> (i) arises in a way described in any of sections CX 6, CX 9, CX 10, or CX 12 to CX 16; or
>
> (ii) is an unclassified benefit; and
>
> (c) is not a benefit excluded from being a fringe benefit by any provision of this subpart.
>
> *Arrangement to provide benefit*

(2) A benefit that is provided to an employee through an arrangement made between their employer and another person for the benefit to be provided is treated as having been provided by the employer.

Past, present, or future employment

(3) It is not necessary to the existence of a fringe benefit that an employment relationship exists when the employee receives the benefit.

Relationship with subpart RD

(4) Sections RD 25 to RD 63 (which relate to fringe benefit tax) deal with the calculation of the taxable value of fringe benefits.

Arrangements

(5) A benefit may be treated as being provided by an employer to an employee under—

(a) section GB 31 (FBT arrangements: general):

(b) section GB 32 (Benefits provided to employee's associates).

Section GB 32 states:

Benefits provided to employee's associates

When this section applies

(1) This section applies when—

(a) a benefit is provided to a person who is associated with an employee of an employer; and

(b) the benefit would be a fringe benefit if provided to the employee; and

(c) the benefit is provided either by the employer or by another person under an arrangement with the employer for providing the benefit; and

(d) the exemption in subsection (2) does not apply.

Exemption for shareholder-employees and corporate associates

(2) Subsection (3) does not apply when—

(a) the benefit is provided by an employer that is a company; and

(b) the employee is a shareholder in the company; and

(c) the person associated with the employee is a company; and

(d) the benefit is not provided under an arrangement that has a purpose of providing the benefit either—

(i) in place of employment income; or

(ii) free from fringe benefit tax.

Benefit treated as provided to employee

(3) For the purposes of the FBT rules, the benefit is treated as provided by the employer to the employee.

Application of section CX 18

(4) Section CX 18 (Benefits provided to associates of both employees and shareholders) applies to determine when a benefit provided to an associate of both an employee and a shareholder is treated as a fringe benefit and not a dividend.

The terms “employee”, “employer” and “employment” are defined for FBT purposes by reference to the PAYE system. The term “PAYE income payments” is defined in section RD 3 as:

> *Meaning generally*
>
> (1) The PAYE rules apply to a PAYE income payment which—
>
> (a) means—
>
> (i) a payment of salary or wages, see section RD 5; or
>
> (ii) extra pay, see section RD 7; or
>
> (iii) a schedular payment, see section RD 8:
>
> (b) does not include—
>
> (i) an amount attributed under section GB 29 (Attribution rule: calculation):
>
> (ii) an amount paid to a shareholder-employee in the circumstances set out in subsection (2)
>
> (iii) an amount paid or benefit provided, by a person (the claimant) who receives a personal service rehabilitation payment from which an amount of tax has been withheld at the rate specified in schedule 4, part I (Rates of tax for schedular payments) or under section RD 18 (Schedular payments without notification), to another person for providing a key aspect of social rehabilitation referred to in paragraph (c) of the definition of personal service rehabilitation payment in section YA 1 (Definitions).

Section RD 27 states:

> **RD 27 Determining fringe benefit values**
>
> *What sections RD 28 to RD 53 do*
>
> (1) Sections RD 28 to RD 53 set out the rules for determining the value of a fringe benefit provided by an employer to an employee in connection with their employment. The taxable value of a fringe benefit when an employee pays an amount for receiving the benefit is dealt with in sections RD 54 to RD 57.
>
> *When value cannot be ascertained*
>
> (2) If, under sections RD 28, RD 29, and RD 33 to RD 41, the value of a fringe benefit cannot be ascertained, the value is the market value or otherwise as the Commissioner determines.
>
> *Meaning of market value*
>
> (3) In subsection (2), market value means the price, at the time at which the goods or services were provided to the employee, for which the goods or services would normally be sold in a sale—
>
> (a) in the open market in New Zealand; and
>
> (b) freely offered; and
>
> (c) made on ordinary trade terms; and
>
> (d) to a member of the public at arm’s length.

When services are provided to an employee, and the services are provided as part of the employer’s business, the fringe benefit is valued in accordance with section RD 41:

Price, amount paid, or fee

(1) The value of a fringe benefit that an employer provides to an employee in services is,—

(a) when an employer normally provides the services as part of their business, the price charged by the employer—

(i) at the time they provided the services; and

(ii) for the same or similar services to the public in the open market in New Zealand; and

(iii) on ordinary trade or professional terms between buyers and sellers independent of each other:

(b) when an employer pays for the services to be provided, dealing at arm's length with the supplier of the services, the amount paid or payable:

(c) if neither paragraph (a) nor (b) applies, the price or fee that the employer or supplier providing the services would at that time have charged the public, had they provided the same or similar services to the public in the open market in New Zealand on ordinary trade or professional terms.

Exclusions

(2) This section does not apply to a service that consists of making available a motor vehicle for private use, providing an employment-related loan, or providing subsidised transport.

Services provided to group of employees

(3) For the purposes of this section, a person who provides services to an employee belonging to a group of employees is treated as providing the same or similar services to the public in the open market in New Zealand on ordinary trade or professional terms if the person provides the same or similar services to a group of persons that—

(a) negotiates the transaction on an arm's-length basis; and

(b) is comparable in number to the group of employees.

Some definitions

(4) In this section,—

amount, for a registered person who may claim input tax for that service, means the GST-inclusive amount

fee and **price**, for a registered person who may claim input tax for that service, means the GST-inclusive fee or price.

Section RD 54(1) provides:

Value of benefit

(1) The taxable value of a fringe benefit is the value of the benefit. Subsection (2) overrides this subsection.

Reduction for payment by employee

(2) If an employee pays an amount for receiving a fringe benefit, the value of the benefit is reduced by the amount paid.

When associate pays amount

(3) If section GB 32 (Benefits provided to employee's associates) applies, the value of the benefit is reduced when a person associated with the employee pays an amount for the benefit.

Exclusions

(4) This section does not apply to—

(a) an employment-related loan:

(b) a payment to acquire or improve an asset if receiving or using the asset does not constitute a fringe benefit.

Section YA 1 defines "employer" and "employee" for the purposes of the FBT rules.

"Employee":

(a) means a person who receives or is entitled to receive a PAYE income payment:

(b) in sections CW 17 (Expenditure on account, and reimbursement, of employees) and CW 18 (Allowance for additional transport costs) includes a person to whom section RD 3(2) to (4) (PAYE income payments) applies:

(c) in the FBT rules, and in the definition of **shareholder employee** (paragraph (b)), does not include a person if the only PAYE income payment received or receivable is—

(i) a payment referred to in section RD 5(1)(b)(iii), (2), (6)(b) and (c) and (7) (Salary or wages):

(ii) a schedular payment referred to in schedule 4, parts A and I (Rates of tax for schedular payments) for which the person is liable for income tax under section BB 1 (Imposition of income tax):

(d) is defined in section DC 15 (Some definitions) for the purposes of sections DC 12 to DC 14 (which relate to share purchase schemes):

(e) for an employer, means an employee of the employer.

"Employer":

(a) means a person who pays or is liable to pay a PAYE income payment:

(b) includes,—

(i) for an unincorporated body of persons other than a partnership, the manager or other principal officer:

(ii) for a partnership, each partner:

(iii) for the estate of a deceased person, a trust, a company in liquidation, an assigned estate, or for any other property vested or controlled in a fiduciary capacity, each person in whom the property has become vested or to whom control of the property has passed:

(iv) the Crown:

(c) in the FBT rules, does not include a person if the only PAYE income payment that they pay or are liable to pay is—

(i) a payment referred to in section RD 5(1)(b)(iii), (3), (6)(b) and (c), and (7) (Salary or wages):

(ii) a schedular payment referred to in schedule 4, parts A and I (Rates of tax for schedular payments):

(d) is defined in section RD 45(6) (Unclassified benefits) for the purposes of that section:

(e) for an employee, means the employer of the employee.

Application of the legislation

1. Commissions received by life agents on their own policies or policies of associated persons

Insurance agents may receive commissions when they sell life insurance policies. Usually an insurance agent's entitlement to commissions is set out under a life agent's terms of engagement or employment contract.

"Income" is not a term of art and has to be examined in accordance with ordinary concepts and usages (*Scott v C of T* (1935) 35 SRNSW 215 at page 219). The courts have identified several criteria that are considered to be the hallmarks of receipts of an income nature. The High Court in *Reid v CIR* (1983) 6 NZTC 61,624 at page 61,629 described the criteria as follows:

- income is something which comes in; and
- income imports the notion of periodicity, re-occurrence and regularity; and
- whether a particular receipt is income depends upon its quality in the hands of the recipient.

An important feature of income is that it is something that comes in. This was emphasised in *Lambe v IR Commrs* (1933) 18 TC 212 where Finlay J said at page 217:

> Of course income may be of various sorts, ... but none the less the [income] tax is a tax on income. It is a tax on what in one form or another goes into a man's pocket. That is the general principle.

Commissions received by life agents on their own policies or the policies of associated persons come in, in the same way that commissions from the sale of policies to unrelated third parties come in.

The major determinant in many cases is the periodic nature of the payment. Generally, commission income is periodic in nature. However, this in itself is not enough. It is necessary to consider the relationship between the life insurer and the life agent to determine the quality of the commission in the hands of the life agent.

Alternative arguments

One possible argument is that commissions received by life agents on their own policies are not income but are the proceeds from mutual transactions.

Mutual transactions

The general principle of income tax known as "mutuality" starts from the premise that a person cannot make a profit from trading with himself or herself, or with a body or association of persons of which the person is a member. In *Sydney Water Board Employees' Credit Union Ltd v FC of T* (1973) ATC 4,129 Barwick J said (at page 4,131):

> The description "mutuality principle" is used, unfortunately as I think, to express the reason for the conclusion that the return to a taxpayer of a share of the surplus of a fund to which he has contributed in common with others after its use for a purpose agreed between them is not income ... **What distinguishes the amount refunded in such circumstances from profit or income is that the payment is made out of moneys which are in substance the moneys of the contributors.** [Emphasis added]

Prima facie the profits from mutual transactions are not income.

There are numerous cases discussing the mutuality principle. Most discuss the situation where a person trades with a body or association of persons of which he or she is a member. There was some discussion of the principle that a person cannot trade with himself or herself in *Dublin Corporation v M'Adam* (1883-1890) 2 TC 387 at page 397. The court stated that:

> There must be, at least, two parties...If these two parties are identical, in my opinion there can be no trading. No man, in my opinion, can trade with himself; he cannot, in my opinion, make, in what is its true sense or meaning, taxable profit by dealing with himself; and in every case of this description it appears to be a question on the construction of the Act whether the two bodies – the body that supplies and the body or class that has to pay – were either identical, or, upon the true construction of the Act, must be admitted to have been held by the Legislature to be identical….

Does the mutuality principle apply?

Although the life agent is the person who *causes* the commission to be paid by taking up the policy on that person's life or the lives of the person's family, the commission is not a return of the life agent's own money. The commission comes from a source outside of the life agent, that is, from the funds of the life insurer. The life agent is paid the commission for introducing business to the life insurer, not for taking out the policy and paying the premiums.

Case law indicates that the mutuality principle only applies when a person trades with himself or herself, that is, there is only one party to the transaction giving rise to the income. Here there are two parties to the transaction. The commission arises from the sale of a life insurance product by one party (the life insurer) to another party (the life agent). It does not matter that the life insurance product is sold by the life insurer through the life agent. There are still two parties to the transaction.

Mutuality principle – conclusion

The mutuality principle does not apply to commissions received by life agents on their own policies.

Discount on premiums

It may also be argued that commissions received by life agents on their own policies should be regarded as discounts from the premiums payable under the policy and not as income. For example, a life agent takes out a policy on his or her life. The premium is $1,000. The life agent receives a commission of $200. The $200 can be seen as a discount, that is, the "real" cost of the policy is $800.

This was the view taken in "Commissions on Life Insurance Sold to Agent's Family" in *Tax Information Bulletin* Volume Four, Number 10 (May 1993), which states:

> Commissions received by agents or employees of Life Insurance Offices who take out life insurance policies on their own lives or on the lives of their immediate family members should be regarded as reductions or discounts from the premiums payable under the policies, and not as assessable income.

The Commissioner now considers that the treatment of commissions as reductions or discounts from the premiums payable under the policies is incorrect. This is because commissions received by life agents on their own policies or the policies of associated persons "come in" and are therefore income. The fact that a commission is set off against a life agent's obligation to pay

premiums does not affect the derivation of the commission. Commissions received by life agents on their own policies are treated in the same way as commissions received from the sale of policies to unrelated third parties.

The commission payment arises from an arrangement between the life agent and the life insurer. The life agent receives the commission for introducing business to the life insurer, not for taking out the policy and paying the premiums.

Conclusion

Commissions received by life agents on their own policies or those of associated persons are income under section CB 1 or CE 1.

2. Life agents' commissions are set off

Life agents may set off commissions received on their own policies or those of associated persons against the premiums payable on their own policies.

Under section BD 3(4), an amount is deemed to have been derived by a person although it has not actually been paid to, or received by, the person, or already become due or receivable:

> Despite subsection (3), income that has not previously been derived by a person is treated as being derived when it is credited in their account or, in some other way, dealt with in their interest or on their behalf.

Case law has established that income is derived under section BD 3(4) when the taxpayer does not receive a payment of that income, but receives some other monetary benefit. This has been found to occur when income that would otherwise have been paid to the taxpayer is diverted for uses that are of benefit to the taxpayer (*Dunn v C of IR* (1974) 1 NZTC 61,245).

When life agents set off the commission, the amount of commission is income under section CB 1 or CE 1. The commission (which would otherwise have been paid to the agent) is diverted for uses that produce other financial benefits to the life agent, that is, payment of the premiums on their own policies.

The practice of setting off commissions on policies may also occur in respect of policies sold to third parties. For example, a life agent sells a policy to an unrelated third party and becomes entitled to a commission. Instead of being paid the commission, the life agent sets the commission off against premiums payable on their own policies. Here, the commission, although not paid to the life agent, is derived by the life agent and is therefore income.

3. Charging of discounted life insurance premiums to life agents or associated persons

It is common for life insurers to allow life agents to receive lower commissions in order to discount premiums to prospective clients. The Commissioner understands that if a life agent agrees that no commission entitlement will arise on the sale of a policy, there is a corresponding reduction in the premiums payable under that policy.

The Commissioner also understands that when life agents agree that no commission entitlement will arise on their own policies or those of associated persons, the premiums payable under those policies are reduced.

Life agents who agree that no commission entitlement will arise on policies sold to third parties are not assessable on any notional commission; that is, the amount of commission that would have been received. As discussed, an important feature of income is that it is something that comes in. When a life agent agrees that no commission entitlement will arise, no income comes in.

This must also be the case when life agents agree that no commission entitlement arises on their own policies or those of associated persons. Because the life agent receives no commission, no income arises.

Alternative arguments

An important feature of income is that it is something that comes in. When life agents agree that no commission entitlement will arise on their own policies no money comes in. They do not receive a commission. However, the issue of convertibility arises if a life agent either takes the commission, or agrees that no entitlement will arise and receives a discounted premium on a policy on the agent's own life or that of an associated person. In particular, does the fact that the life agent can receive the commission in lieu of the discounted premium mean that the discounted premium is convertible into money, and therefore assessable?

Case law

The principle of convertibility was initially laid down in *Tennant v Smith* [1892] 3 TC 158. *Tennant* involved a bank employee who received a benefit in the form of rent-free accommodation. The issue was whether the accommodation was assessable under Schedule E of the United Kingdom legislation (by virtue of the words "salaries, fees, wages, perquisites or profits payable"). The court held that the taxpayer would only be taxable if what he received was convertible into money, that is, was money or money's worth. Because the taxpayer could not sublet the accommodation or turn it to pecuniary account in any other way, he was not taxed.

The principle of convertibility has been discussed and applied by the New Zealand courts on several occasions. See *C of IR v Parson (No. 2)* (1968) NZLR 574, *Stagg v Inland Revenue Commissioner* (1959) NZLR 1,252 and *Dawson v Commissioner of Inland Revenue* (1978) 3 NZTC 61,252.

The convertibility test is normally satisfied by demonstrating that the benefit may be sold or exchanged for money. In *Stagg* the value of holiday airfares given to an employee was held not to be assessable income of the employee. The employee could not sell the fares or require the company to give him the equivalent cash value.

However, it is clear from the case law that there are other ways in which convertibility can be satisfied. See *Abbott v Philbin* [1961] 2 All ER 763 and *Heaton (Inspector of Taxes) v Bell* [1969] 2 All ER 70.

The principle of convertibility was considered by the New Zealand Supreme Court in *Dawson*. The taxpayer subscribed for debenture stock under a debenture holders' colour television plan. Under that plan a person could subscribe for debenture stock and would receive in return a television free of hire for five years. No interest was payable on the debentures.

The Commissioner argued that the use of the television set was the substitution of one form of a benefit for another, that is, interest, and in taking the hire of the

set rather than the payment of interest, the taxpayer received a benefit that could be valued in terms of money.

McMullin J said at page 61,258:

> In the view which I take of this matter, it is of some importance to note that [the] Objector did not apply for a television set as an alternative to an interest-bearing investment. It is true that it was open to him initially to choose to invest in interest-bearing stock as, I have no doubt, many other investors did, but he completed his application for a television set and a television set only.

The court held that the benefit the taxpayer received was that he did not have to pay rental for the television. That benefit did not constitute income in the ordinary sense because the benefit received by the taxpayer was not in monetary form, nor was it capable of being sold, surrendered, assigned, or mortgaged for money or money's worth.

Arguably, *Dawson* provides some support for the view that the receipt of a discounted premium is convertible into money or money's worth, the discounted premium being a substitution for the commission. It may be inferred from the court's comments in *Dawson* that if the taxpayer had the option of investing and receiving either a television set or an interest-bearing investment, and in fact received a television set, the benefit would be convertible into money.

However, it is considered the better view is that discounted premiums are not convertible into money or money's worth.

The fact that a life agent initially has the choice of receiving a commission, or not receiving a commission and enjoying a discounted premium, is not relevant. The issue of convertibility is considered at the time the taxpayer receives the benefit.

If a life agent chooses to receive a commission, no question of convertibility arises because the commission is money.

However, when a life agent chooses to receive a discounted premium, it is the discounted premium itself that must be convertible into money or money's worth. At the time the discounted premium is received it cannot be converted into money because the life agent no longer has the option to receive any commission. Therefore, the convertibility principle does not apply.

Conclusion

When a life agent or persons associated with the life agent receive discounted policies, the amount of the discount is not income of the life agent.

4. FBT and discounted policies

A life insurer who provides discounted premiums to life agents or persons associated with the life agent may be liable for FBT.

For the purposes of FBT a life agent is an "employee", regardless of whether the life agent is an employee or an independent contractor at common law.

Employee versus independent contractor

The terms "employee", "employer" and "employment" are defined for FBT purposes by reference to the PAYE system.

Section YA 1 defines "employee" for the purposes of the FBT rules as meaning:

> … a person who receives or is entitled to receive a PAYE income payment.

There are certain exclusions in the definition of "employee" for the purposes of the FBT rules, but they are not applicable to the arrangements in these Rulings.

Section RD 3 defines "PAYE income payment" as:

> (1) The PAYE rules apply to a PAYE income payment which—
>
> (a) means—
>
> (i) a payment of salary or wages, see section RD 5; or
>
> (ii) extra pay, see section RD 7; or
>
> (iii) a schedular payment, see section RD 8:
>
> (b) does not include—
>
> (i) an amount attributed under section GB 29 (Attribution rule: calculation):
>
> (ii) an amount paid to a shareholder-employee in the circumstances set out in subsection (2).

Under section RD 8, all payments of the classes specified in Schedule 4 are schedular payments for the purposes of the PAYE rules. Included in Part G of Schedule 4 are commissions or other remuneration to insurance agents or sub-agents, or to salespeople.

A life agent who is an employee at common law is an "employee" for the purposes of FBT because they receive a type of PAYE income payment, namely salary and wages. A life agent who is an independent contractor at common law is also an "employee" for the purposes of FBT because they receive a type of PAYE income payment, namely schedular payments.

Discounts on family policies

Under the arrangements covered by these Rulings, if an employer provides a benefit to an associated person of any of the employer's employees (for example, a relative) and the benefit would have been a fringe benefit if provided to the employee, section GB 32 deems the benefit to be a benefit provided to the employee.

From 1 April 2010, for the purposes of the arrangement, "associated person" is defined in section YB 1. An "associated person" includes two persons who are relatives as defined in section YB 4.

A relative of a life agent is any person connected with the life agent:

- by blood relationship if within the second degree of relationship (a child by adoption is treated as a natural child); or
- by marriage, civil union or de facto relationship; or
- by blood relationship to the spouse or partner of the life agent (if within the second degree of blood relationship to the spouse or partner).

For periods before 1 April 2010, the degree of blood relationship required to establish that a person is a relative of an employee is four degrees of blood relationship.

Is there a fringe benefit?

As discussed, when a life agent agrees that no commission entitlement will arise and receives a discounted premium, that discounted premium is not income of the life agent.

A discounted premium that represents a reduction in charges other than commission is also not income. A discount is not regarded as income. Income is something that comes in, not something that is saved from going out (see *Tennant* per Lord Halsbury at page 165).

The issue then is whether life insurance policies provided by life insurers to life agents or associated persons, where the premiums are discounted, constitute fringe benefits.

Analysis

Section CX 2 defines "fringe benefit" for the purposes of the FBT rules:

> *Meaning*
>
> (1) A **fringe benefit** is a benefit that—
>
> (a) is provided by an employer to an employee in connection with their employment; and
>
> (b) either—
>
> (i) arises in a way described in any of sections CX 6, CX 9, CX 10, or CX 12 to CX 16; or
>
> (ii) is an unclassified benefit; and
>
> (c) is not a benefit excluded from being a fringe benefit by any provision of this subpart.
>
> *Arrangement to provide benefit*
>
> (2) A benefit that is provided to an employee through an arrangement made between their employer and another person for the benefit to be provided is treated as having been provided by the employer.
>
> *Past, present, or future employment*
>
> (3) It is not necessary to the existence of a fringe benefit that an employment relationship exists when the employee receives the benefit.
>
> *Relationship with subpart RD*
>
> (4) Sections RD 25 to RD 63 (which relate to fringe benefit tax) deal with the calculation of the taxable value of fringe benefits.
>
> *Arrangements*
>
> (5) A benefit may be treated as being provided by an employer to an employee under—
>
> (a) section GB 31 (FBT arrangements: general):
>
> (b) section GB 32 (Benefits provided to employee's associates).

It is clear from the opening words of CX 2(1) that in order for there to be a fringe benefit, there must be some benefit to the employee, provided by the employee's employer. A fringe benefit is any benefit provided by the employer to the employee in connection with their employment, unless expressly excluded by subpart CX. That benefit is then valued under section RD 27, and its taxable value is calculated under section RD 54. The value of the benefit and its taxable value are discussed in more detail below.

If a life agent or associated person purchases a life insurance policy from the life agent's employer, there is a benefit provided to the life agent if the policy is provided in connection with the life agent's employment.

A life agent may have a discretion to reduce his or her commission in order to reduce premiums on policies sold to members of the public as well as to themselves or persons associated with them (for example, relatives). A life agent, or associated person, who enjoys a discounted premium on their own life insurance policy or family policies may receive a benefit, if that discount is provided by the life agent's employer in connection with the life agent's employment. However, if the same discount is available to members of the public, then the discount may not be provided in connection with the life agent's employment and will not be a fringe benefit. Whether or not a benefit has been provided in connection with the life agent's employment will depend on the facts of each case.

The benefit in these situations is the receipt of services (the life insurance policy) from the employer by the employee in connection with their employment and is consequently a fringe benefit under section CX 2. This was discussed in a Question We've Been Asked entitled "The Meaning of 'Benefit' for FBT Purposes" in *Tax Information Bulletin*, Volume 18, Number 2 (March 2006). The amount of any discount and any consideration provided by the employee will be relevant to determining the taxable value of the benefit.

Section CX 16 applies when an employer pays a specified insurance premium or makes a contribution to the insurance fund of a friendly society for the benefit of an employee. In the Arrangement covered by this Ruling, section CX 16 does not apply because the life insurer does not pay the life insurance premiums of the life agent or persons associated with the agent. Section CX 14 also does not apply to the Arrangement covered by the Ruling. Section CX 14 applies to "sickness, accident, or death benefit funds" as defined in section YA 1.

Value of the benefit

The Act provides methods for valuing a fringe benefit in section RD 27. Section RD 41 determines the value of services provided to an employee when they are provided as part of the employer's business.

In the Arrangement covered by these Rulings, the fringe benefit is the provision of a life insurance policy. The life insurer is in the business of selling such life insurance policies to members of the public. Therefore, section RD 41 applies to determine the value of the fringe benefit.

Section RD 41 provides that the value of a benefit that is normally provided by an employer as part of its business, will be the price charged at the time they provide the same or similar services, on ordinary trade or professional terms between buyers and sellers independent of each other. It is a question of fact whether the price charged to the life agent or associated person for the policy is the same as is customarily charged to a member of the public in the open market

on ordinary trade terms between buyers and sellers independent of each other. Therefore, the extent to which the fringe benefit (the life insurance policy) is subject to FBT will depend on the extent to which any discounts provided to a life agent, or persons associated with the life agent, are greater than the discounts available to members of the public.

The taxable value of the fringe benefit is calculated under section RD 54. Section RD 54 provides that the taxable value of a fringe benefit will be the value of the benefit reduced by any amount paid by the employee, or an associated person, for that benefit. There will be no taxable value if the amount paid for the policy is the same as, or exceeds, the price customarily paid by a member of the public in the open market on ordinary trade terms between buyers and sellers independent of each other.

Expenditure on account of an employee

The Ruling covers the situation when an employer (the life insurer) provides a benefit to the employee (the life agent) or person associated with the life agent (for example, a relative) by discounting the premiums payable by the life agent on the insurance policy. It does not seek to address the situation when the life insurer *pays* the life insurance premium of a life agent.

When a life insurer pays a life agent's insurance premiums, that expenditure will be expenditure on account of an employee if the employee is liable to pay the insurance premiums. Expenditure on account of an employee is employment income under section CE 1 and is assessable income to the employee, subject to the exclusions under section CE 5(3).

When a life insurer pays a life agent's insurance premiums, and the life insurer is liable for those premiums, that expenditure is a fringe benefit (unless expressly excluded from the definition of fringe benefit in section CX 2).

Period of Rulings

These Rulings commence on the first day of the 2008/09 income year. The previous Rulings expired on 31 December 2004. However, the Commissioner is of the view that the same principles and conclusions as set out in these Rulings would apply in respect of the period beginning on 1 January 2005 and ending on 31 March 2008.