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Comptroller of Income Tax v BBO [2014] SGCA 10

On 4 February 2014, the Singapore Court of Appeal ("SCA") issued a decision concerning the taxability of gains arising from an insurance company's disposal of shares. This is the first local case that deals with tax treatment of investment gains accruing to insurance companies.

Facts of the case

- BBO is a company registered in Singapore. It belongs to the C group of companies and carries on business of a general insurer.
- Under the auspices of the Insurance Act (Cap 142), BBO established a Singapore Insurance Fund ("SIF") and an Offshore Insurance Fund ("OIF") in respect of its Singapore and overseas policies respectively. BBO used the SIF to invest in C shares and the OIF to invest in C, D, and E shares (collectively, the "Shares").
- Between 1972 and 1994, BBO sold some of the shares in C and the gains arising from these disposals were taxed.
- In 2001, an unrelated company, F, made a general offer for C. Pursuant to the takeover offer, BBO sold to F its entire holding of C shares. A year later in 2002, BBO sold its portfolio of D and E shares.
- BBO derived gains of approximately $98.6 million from the sale of Shares, of which 90% is attributable to gains from the sale of C shares. In total, the Shares amounted to some 36% of the total value of the SIF and OIF.

The Comptroller of Income Tax ("CIT") contended that the gains arising from the sale of Shares in 2001 and 2002 are taxable.

BBO disagreed with the CIT's position and the Income Tax Board of Review ("BOR") concluded in BBO's favour upon the former's appeal. The CIT then appealed against the BOR's decision to the High Court, which again upheld the findings by the BOR.

Issues addressed by the SCA

The SCA had to determine whether profits made by BBO on the disposal of Shares were profits arising out of BBO's carrying on of an insurance business and therefore taxable under Section 10(1)(a) of the Income Tax Act (ITA).

The main argument advanced by the CIT before the SCA rests primarily on the fact that the Insurance Act[1] requires premiums obtained by an insurer from underwriting risks to be retained in separate insurance funds (i.e. either the SIF or OIF) so as to meet liabilities arising from those risks underwritten.

Assets purchased with the premiums obtained and subsequently realised at a profit

[1] Section 17(1) of the Insurance Act

by an insurer would thus give rise to a gain which, in the CIT's view, is part of the taxable insurance business. An exception to this is when monies or assets in the insurance funds are determined to be surplus to requirements, and, subject to fulfilling the regulatory requirements, such surplus are subsequently transferred from the insurance funds and into the shareholder's fund.

The CIT argued that since the Shares remained in BBO's SIF and OIF, they remain a part of the assets of BBO's insurance business and accordingly, the gains from the sale of Shares arose from BBO's trade or business and are taxable under s10(1)(a) of the ITA.

Judgement of the SCA

The SCA reaffirmed the decision of the High Court and held that the Shares are capital assets and gains arising from their disposal are not taxable under the ITA.

The SCA felt that the relevant considerations in cases involving the taxation of investment gains by insurance (or similar) companies may be summarised as follows:

- The crucial question is whether the gain in question is a mere enhancement of value by realising a security or whether it was made in an operation of business in carrying out a scheme for profit-making.
- This is ultimately a question of fact to be determined according to ordinary concepts having regard particularly to the circumstances under which, and the purposes for which, the investments were acquired and held by the taxpayer.
- However, 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 operation of business in carrying out a scheme for profit-making (unless, of course, there is cogent evidence that the investments were acquired and held as capital assets).

In arriving at the above decision, the SCA agreed with several propositions advanced by BBO, with the salient points of the taxpayer's arguments being:

- The purpose of the Insurance Act is to regulate the insurance business and not to govern the taxation of insurers;
- The requirement to establish separate insurance funds and the shareholders fund is primarily to protect the interests of policy holders and should not be determinative of the tax treatment of particular assets or investments of those funds; and
- Assets of a company should not be characterised as revenue assets just because they could be applied to meet the company's liabilities in a situation of liquidation or otherwise.

Having concluded that the Insurance Act is not determinative of the issue of whether the gains arose in the operation of BBO's trade or business in carrying out a profit-making scheme, the SCA then proceeded to analyse the following factors in determining whether the gains from the sale of Shares were capital in nature:

- **Motive of the taxpayer**
  The SCA agreed with BBO's contention that it held the Shares to promote the long-term strategic interest of itself and the C group. This was evidenced by, inter alia, numerous cross-holdings of shares and cross-directorships between companies within the C group and the fact that any decision to sell any shares or rights in the companies within the C group was closely scrutinised by the Investment Committee of the group to ensure that the appropriate level of shareholding and control were maintained.

- **Duration of ownership**
  The shares were held by BBO for a relatively long period of time (between 20 to 30 years) and the SCA was of the view that this is in line with the corporate preservation strategy of the group.

- **Multiplicity of disposal of shares**
  There were few disposals of the Shares by BBO throughout its relatively long period of holding and SCA noted that previous disposals (of C shares) were made mostly to other companies within the C group which further reinforced the corporate preservation strategy.

- **Financing**
  BBO did not need to and did not in fact liquidate the Shares to meet its liabilities in the insurance business. The SCA thus held the view that there was a weak nexus between the sale of Shares and the carrying on of BBO's insurance business.

Based on the totality of evidence, the SCA found that all factors support BBO's contention that it acquired the Shares to safeguard the long-term strategic interests of the C group and the Shares were eventually realised pursuant to the takeover of C. The Shares are thus capital assets of BBO and their disposal gave rise to capital gains which are not taxable.

Our comments

This case is important insofar as it is the first local decision on the tax treatment of investment gains by insurance companies, but is also significant in other aspects.

Firstly, it emphasises the general principle that the characterisation of gains as income or capital are to be founded on ordinary principles of revenue law, which is in turn dependent on an assessment of the totality of evidence. Although the SCA acknowledged that, as a matter of practicality, the nature of insurance businesses would ordinary give rise to an inference that the gains (from the sale of shares) arose in the course of trade or in the operation of business in carrying out a scheme for profit-making, there is no immutable law or rule which states that such gains would invariably be of an income nature, especially if there is cogent evidence to the contrary.

The SCA's *dictum*[2] also elucidated the broader principle that regulatory frameworks may have little or no impact on taxation rules, given that regulatory measures are prescribed for a host of reasons other than tax. As such, the decision in CIT v BBO should be welcomed not only by the insurance industry, but also by the broader community of taxpayers in regulated industries.

The High Court had earlier found that the "badges of trade" test is not directly relevant to the case because it is not disputed that BBO is carrying on business as a general insurer. This is unlike previous cases considered by the Singapore Courts, where the taxability of gains arising from the disposal of assets (usually shares or immovable properties) largely turns on a determination of whether the taxpayer is carrying on a business of dealing in the asset realised. However, factors regarded by the High Court as relevant in determining whether the Shares are capital assets overlap significantly with the "badges of trade" test. These include, the motive of the taxpayer, the duration of ownership, whether there has been a multiplicity of similar transactions, the method of financing and the circumstances for realisation. The consideration of these factors was subsequently reaffirmed by the SCA.

Lastly, it will be interesting to see if Section 13Z[3] of the ITA will be amended. This exemption is currently not applicable to disposal of shares the gains or profits of which are included as part of the income of an insurance company whose profits are taxed under Section 26 of the ITA. This position appears to be predicated on the view that all gains made by such insurance company are of an income nature and it should be noted that Section 13Z was introduced at a time when the BBO case was making its way through the tax appeal process. In light of the clarity provided by the SCA, one hopes that the shelter provided by the safe harbour provision could be extended to shelter insurance companies as well.

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[2] Para 48

[3] Section 13Z exempts certain gains derived by a company from the disposal of ordinary shares legally and beneficially owned in another company if the divesting company has owned at least 20% of the ordinary shares in the latter company for at least 24 months immediately before the disposal

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