IN THE STATUTORY TRIBUNAL, FIJI ISLANDS
SITTING AS THE TAX TRIBUNAL

Income Tax Appeal No 6 of 2008

BETWEEN: **COMPANY "B"**

Applicant

AND: **FIJI REVENUE & CUSTOMS AUTHORITY**

Respondent

Counsel: **Mr A Bale for the Appellant**
Ms T.T Rayawa for the Respondent

Dates of Hearing : **Tuesday 1 November 2011;**
Wednesday 2 November 2011;
Monday 14 November 2011.

Date of Judgment: **Monday 28 November 2011**

Judgment of: **Mr Andrew J See Resident Magistrate.**

JUDGMENT

DEDUCTIBILITY OF EXPENSES – Section 19(1) INCOME TAX ACT (CAP 201) – keyman insurance policies; determination of factors relating to capital and revenue expenses.

Background

1. The Applicant, also hereafter referred to as "Company B"[1], is a limited liability company having its registered office in Vatuwaqa, Suva. The company carries on the business of commercial and packaging printing.

[1] In accordance with Section 89(6) of the *Tax Administration Decree* 2009. the identity and affairs of the Applicant must be concealed.

2. Company B took out two insurance policies with a Fijian Life Insurance Company, now part of a South Pacific bank. The first policy that commenced in 2002, was referred to as a 'Bula Life' policy and was taken out by the Applicant to safeguard against the death or terminal illness of its Managing Director. The second policy that was taken out in 2004, was referred to as a 'Bula Scholar' policy. That policy had a life of 15 years and provides for amongst other things, an endowment of $700,000.00 to be paid to the Applicant, should its Managing Director survive for the policy's duration.

3. In the Applicant's lodged Company Income Tax Returns for the periods Financial Years Ending 2003 and 2004, the Respondent had initially approved the deductibility of the insurance premium expenses in relation to both policies, as allowable revenue earning expenses. It is accepted between the parties, that at the time these returns were submitted, the Applicant had not identified the specific nature of these insurance expenses.

4. That information was nonetheless provided in the 2005 End of Year Return, subsequently causing the Authority to reassess its position.

5. What followed, is that the Respondent Authority amended its earlier assessments disallowing the deductions, on the basis that the premium expenses were non-deductible expenses for the purpose of Section 19(1) of the *Income Tax Act Cap 201.* Specifically, that "premium paid in respect of Keymans policy, claimed as an expense, (were regarded as being) of (a) capital nature".[2]

6. The Respondent applied the same approach to the subsequent returns lodged by the Applicant in Years Ending 2005 and 2006.

[2] See for example Notice of Amended Assessment #2 Year Ended 31 December 2004 (Issued 17 January 2007)

7. This application for review arises out of a Notice of Appeal lodged under the now repealed Section 62 (6) of the *Income Tax Act*.[3] The Notice of Appeal dated 3 July 2008, was lodged by Applicant on 4 July 2008. The application for review, relates to the Objection Decision of the Respondent issued on 2 June 2008, disallowing the policy premiums paid by the Appellant in the years 31 December 2003 to 31 December 2006, as allowable tax deductions.

Grounds of Appeal

8. The Grounds of Appeal are as follows:-

   (i) That the Commissioner (now read Authority) was wrong in disallowing the Keyman Insurance policy premiums paid for by the Appellant for the years ended 31st December 2003 to 2006 as an allowable deduction for tax purposes.

   (ii) That the Commissioner was wrong in holding that because a Keyman Insurance Policy was acquired to protect the business structure of the company, it was to be considered as a capital payment.

   (iii) That as a result, the Commissioner has raised revised income Tax Assessments for the years ended 31 December 2003 to 2006 which are greatly excessive and (sic) be revised or set aside and the State do pay to the appellant the costs of his (sic) appeal.

   (iv) That as a result of the revised assessments, the penalties that the Commissioner has imposed are greatly excessive and be revised or set aside given the prior diligent conduct of the above taxpayer of its tax affairs.

   (v) Such further and other grounds that the Court may be advised in due course.

9. The application is heard in accordance with the relevant provisions of the *Tax Administration Decree* 2009 and the *Magistrates Court (Amendment) Decree* 2011.

[3] See *Tax Administration Decree 50/2009*

Issues for Determination

10. In the Agreed Statement of Facts prepared by the parties and filed in the tribunal on 26 August 2011, it was accepted that the issues for determination are:-
    a. Whether such insurance premiums paid on the Endowment Insurance Policy and the other Insurance Policy, are deductible expenses; and
    b. Whether such premiums that were paid in regards to these policies were to secure a capital receipt in the future.

Relevant Facts

11. Company B was founded in 1991 and according to its Managing Director, Mr K, who gave evidence, is the second largest printer in Fiji. The company is owned by Mr K (70% shareholder) and his three brothers (30%) all of whom are Directors in the company. Mr K is the only brother who resides in Fiji. Mr K gave evidence that he was responsible for the day to day business of the Company, including responsibility and oversight of sales, production, shift supervision and staff. His evidence was that "I am the keyman of the company, Jack of all trades".

12. Mr K spoke of the reason causing him to take out the first insurance policy in 2002. He says in evidence that he was motivated at the time by the accidental deaths of several other company Directors both in New Zealand and Fiji, where later on, their businesses closed because of the financial impact of their deaths. He stated, "this gave me some reason to secure the policy for my business...to guard against creditors, liabilities and loans." There was no evidence before the Tribunal as to whether or not Mr K in his private capacity, held his own life insurance policy.

13. On 25 June 2002, there appears to have been an Annual General Meeting of the Appellant, of which there were two attendees, the Managing Director and the

Company Secretary/Director of Finance.[4] The Minutes of that Meeting deal with only one matter, that being 'keyman' Insurance.[5]

14. The Minutes state:

> *It was confirmed by the above directors that discussion had now been concluded in respect of insurance cover to be proposed by the Business on the life of Mr K (key person).*
>
> *The purpose in the proposing the cover is to make available to the Business in the event of the [death/total and permanent disablement/traumatic illness] of Mr K (key person).*
>
> *IT WAS THEREFORE RESOLVED that the sum of FJD$750,000.00 with Colonial Insurance Company be proposed by the Business on the life of Mr K (key person).*
>
> *IT WAS NOTED that as the Policy had been proposed for the purpose of providing the Business with a sum of money which would assist in meeting its continuing expenses and other revenue outgoings in consequence of the [death/total and permanent disablement/traumatic illness] of Mr K (key person), the premiums paid in respect of the policy would be TAX DEDUCTIABLE (sic) and any proceeds of the policy should be treated as ASSESSABLE INCOME TO THE BUSINESS.*

15. The minutes were signed by the two Directors.

16. As the evidence of Mr K and the Agreed Bundle of Documents provided by the parties reveals,[6] a 'Bula Life' policy was subsequently taken out by the Company. The policy had a commencement date of 01/10/2002 and a Risk Cease date of 01/10/2059. The identified policy benefits were as follows: A $750,000 Whole of

---

4 See Exhibit 2 (Agreed Bundle of Documents Tab 8)

5 I use the term keyman and keyperson interchangeably and by necessity only, on the basis that while the case law at this point in time refers to the schemes as keyman insurance schemes, the gender neutral term is clearly keyperson.

6 See Tab 5 of Exhibit 2

Life Benefit arising out of Mr K's death or reaching the cease date. A terminal illness benefit of $375,000 in the case of Mr K contracting a defined illness and where it is unlikely that the life insured was to survive six months; and a payment of $750,000 in the case of Mr K's accidental death.

17. The policy required that Company B pay a fixed premium each month of $2774.14.

18. In 2003, Company B purchased a five acre industrial site. According to Mr K and the Company Accountant who also gave evidence, the purpose of acquiring this property was to establish a large Industrial Park that would also house the business of the Company.[7]

19. Mr K stated that his Company took the decision to take out a further insurance policy under the Product Name, 'Bula Scholar', as a means of using the premium contribution to secure funding for the development of the industrial park. It should be noted here, that the policies could be surrendered after a minimum time period and therefore held an increasing capital value that could be utilised for securing further loan monies.

20. At an Annual General Meeting of the Company held on 20 April 2004 in which Mr K and the Company Secretary were the only two Directors in attendance, minutes of the meeting resolved that:

> *Bula Scholar*
>
> *It was confirmed by the above directors that discussion had now been concluded in respect of insurance cover to be proposed by the Business on Bula Scholar Money Back Policy.*
>
> *The purpose in the proposing the cover is to make available to the Business for providing [DEBT GUARANTEES] a capital sum of money which would assist the Business securing [commercial loans].*

[7] See Exhibit 8.

IT WAS THEREFORE RESOLVED that the sum of FJD700,000.00 with COLONIAL INSURANCE COMPANY be proposed by the Business.

IT WAS NOTED that as the Policy had been proposed for the purpose of providing the Business in securing commercial loans and providing loan guarantees, the premiums paid in respect of the policy would be TAX DEDUCTIABLE (sic) and any proceeds of the policy should be treated as ASSESSABLE INCOME TO THE BUSINESS

21. The Applicant subsequently took out the Bula Scholar policy. The policy had a commencement date of 15/06/2004 and a risk cease date of 15/06/2019.[8]

22. The policy (on occasions during the proceedings referred to by Counsel as an 'endowment policy') provides for:

    a. The payment of five equal instalments of $140,000 in yearly intervals on the policy anniversary. The first payment will be made on 15/06/2015, provided the life insured survives to the policy anniversary on which each instalment is due and all accumulated bonus will be paid only with the fifth instalment should it be paid.
    b. The payment of $700,000.00 plus accumulated bonus if the Life insured dies prior to 15/06/2019.

Events That Gave Rise to Re-assessment of Treatment of Premiums as Non-Deductible Expense

23. Counsel for the Respondent called two witnesses of the Authority to give evidence in relation to the way in which the Income Tax Returns of the Company were processed and the determination regarding deductibility made. The first witness was the Manager Assessment, Inland Revenue Services. His evidence was that this was the first case of "a keyman policy" that he had come across in his 30 years within the Authority. He indicated that he had viewed the correspondence received

[8] See Document at Tab 4 of Exhibit 2

from Company B's Accountant dated 28 September 2007[9], undertaken research into the matter and discussed with his staff. Following that process, he advised his Principal Assessor to confirm the decision of the Authority that the premiums were not allowable expenses

24. The Principal Assessor, also a witness in proceedings, communicated the position of the Authority to Company B on 13 December 2007, after which time the Applicant's legal representative, lodged an Objection Letter dated 18 December 2007.

25. The Objection Letter is quite extensive, insofar as it seeks to provide an overview of why Keyperson Insurance schemes should be recognised as falling within the deductible expenses of the business. It should be noted though, that nowhere within that documentation does it provide an understanding as to how Company B's specific treatment of the keyperson scheme would work. It is also further noted, that the Applicant's correspondence to the Authority and in some respects the Authority's correspondence to the Applicant, blurs to some extent the obvious distinction between the Bula Life and Bula Scholar policies. That is, Company B's Accountant, who was also a witness in proceedings, seemed to refer to both policies as 'Keyman', however despite the Grounds of Appeal being quite clear on this point, Counsel for the Applicant during the conduct of proceedings, seemed on occasion to be less inclined to assume that position.

26. On 2 June 2008, the Authority provided the Applicant, with its Notice of Tax Decision ("the Objection Decision"). It is noted that the decision provides no reasons whatsoever and this seems to be an issue that needs to be addressed by the Authority to ensure that taxpayers are provided the basis for which a decision was made.[10]

---

9 The Accountant had also provided an earlier communication on 13 February 2007.

10 While it is noted that Section 83 of the *Tax Administration Decree* 2009 requires the Authority to provide such reasons following an application for review, the Decree also anticipates that these could be provided at the time of the decision. The latter approach would be far more transparent and informative for all concerned and accords with the usual principles of administrative law.

Reasons for Objection Decision

27. By Directions Order issued on 2 September 2011, the Authority was required to provide the Applicant with its reasons in reaching its decision. The reasons set out by Counsel for the Respondent, Ms Rayawa in a document dated 25 October 2011 are as follows:-

- *The taxpayer has taken out an Endowment Insurance Policy and a "Split Purpose" Life Insurance Policy ... to secure and protect the company from its liability as creditors and other business risks.*
- *Premium paid against such policy is capital as is (sic) secures the business structure of the company.*
- *Any policy taken out for the ultimate benefit of the company, such payment for premium is treated as capital payment rather than revenue.*
- *Premiums on the insurance of partners (also apply to directors/shareholders) intended to assist in the payment of a liability to them upon death of (sic) retirement are not allowable deductions (FCT v Wells (1971) 2ATR 552.*
- *The premiums are to secure a capital receipt in future therefore are not allowable as deductions under section 19 of the Income Tax Act Cap 201.*

The Nature of the Policies

28. It is clear on the evidence before the tribunal, that the policies taken out by Company B, were not sufficiently distinguished from each other during the tax assessment phase, nor in the subsequent correspondence from the Applicant. The evidence of the Managing Director regarding the purpose of the policies seems to be the best evidence of corporate intent. As mentioned earlier, It is perhaps not correct to regard the policies collectively as keyperson insurance policies.[11] Having said that, both parties appear to have done so on various occasions.

29. In relation to the Bula Life Policy (referred to by the Authority as the split purpose policy), it was clear that Company B had sought to regard it as a keyman policy.

[11] The endowment policy or evidence of Company B in relation to this policy, does not make any mention of any contingency planning or replacement expenditure associated with the possible demise of the Managing Director. That would be a feature of a keyperson scheme.

That being said, there was no evidence of how Company B sought to put into effect the proceeds of any revenue from the policy. The evidence of Mr K was simply that the proceeds were to "guard against creditors, liabilities and loans". To classify such a scheme as a keyperson scheme, appears to be an overstatement and an attempt to otherwise dress up a scheme that is designed to do no more than protect the capital stock of the firm. Compare for example, the purpose of the keyperson scheme in *Risby Forest Industries Pty Ltd v Commissioner of Taxation*[12] where the scheme's purpose was described as:

> *A hedge for the company against the possibility of Mr Risby's death before he retired from the position of managing director. It was an amount intended for use by the company as an offset against any increased salary which it would have had to pay to obtain a suitable external senior executive. It was also intended to be applied towards payment of other costs which would result from Mr Risby's death including the costs of further staff training and of searching for a new senior executive or executive.*

30. In Risby's case, it is quite clear the purpose of the insurance was to fill the place of a revenue item. I note the arguments of the Applicant's Counsel in relation to the well established Fijian law that canvases the relevance of Australian law when considering the implications of Section 19(1)(b) of the Act.[13] I use Australian case law in this area, only for the purpose of describing the features of a keyperson scheme. In doing that, it would seem that for a keyperson insurance premium to be properly classified this way, requires that its purpose should be definable and the projected proceeds (that would be presumably assessable) capable of being quarantined and specified within the books of the company.[14] As the Principal

---

12 88 ATC 4683 at 4686

13 See the decision of *The Commissioner of Inland Revenue v The Flour Mills of Fiji Limited.* Civil Appeal No 6 of 1985. 20 July 1985

14 Contrast this approach to that described in *Rydell Australia Pty Ltd v Federal Commissioner of Taxation* 99 ATC 2050, where the premiums of a keyman insurance policy were capitalised on the balance sheet as investment in life insurance policies.

Assessor's evidence revealed, the Authority has and would have no way of tracking revenue arising out of policy proceeds in any event. As an observation only, there would be clearly administrative problems in monitoring keyperson schemes that are held against the revenue accounts of a firm. In the first place, the age of the policy (unless it was surrendered) would mean that the revenue account would need to be monitored to ensure that the proceeds were ultimately brought into account. There may be additional difficulties in tracking such schemes, in the case where a company may close or be sold off. These issues are not insurmountable, however clearly require a higher level of scrutiny for the authority.

Submissions of the Applicant

31. The Applicant's submission was supported with a large list of relevant case law. The submission set out the backdrop to how a keyperson insurance scheme worked and demonstrated the benefits such protection have in safeguarding against the loss of a key person. The submissions did not identify the precise expenses that would be incurred by the Company through the loss (and presumably) replacement of Mr K. In his submissions, Counsel for the Applicant states that the structure of Section 19(1) of the *Income Tax Act 1985* (Cap 201) causes difficulties with its interpretation.

32. While I agree with Counsel's submission, that the provision is written in the negative, in my view it is easily transformed into the positive, to be interpreted to read:

> *Any disbursements or expenses being money (..) wholly and exclusively laid out or expended for the purpose of the trade, business, profession, employment or vocation of the taxpayer* .....is a deductible expense.

33. Section 19(1)(i) requires less effort, as it simply states :

> *Any expenditure or loss of a capital nature* is not a deductible expense.

34. I note that at least since *Morgan v Tate & Lyle Ltd,*[15] the Privy Council acknowledged differences in the structure of the laws of other Commonwealth countries and England. In *Morgan v Tate*, like the Australian equivalent, the New Zealand law has as its focus deductions "not exclusively incurred in the production of assessable income". In the case of the English law it would seem as far back as 1842, that approach has been to disallow expenditure "not being money wholly and exclusively laid out or expended for the purposes of the trade, profession, employment or vocation". A more comprehensive treatment of the differences and rationale behind maintaining the body of law that relies on the English principles, is set out within *The Flour Mills* case.[16]

35. It should be noted at this point, that Section 19(1)(b) of the *Income Tax Act 1985* (Cap 201) is framed slightly differently from its founding English provision. I note the observations at the time by the Court of Appeal in *Flour Mills,* that:

> *The current English provision* (Section 130 of the *Income and Corporation Taxes Act* 1970) *is for all practical and present purposes identical;*[17] and that
>
> *The statutory provision under consideration is the same as the provision obtaining in England*[18]*,*

It is still nonetheless the fact, that the class of terms provided for within Section 19(1)(I)(b) do differ from the English law. That departure took place with the amendment to the repealed *Income Tax Ordinance 1964* (Cap 152)

36. The former provision of the Ordinance, Section 3(2) read:

---

15 [1955] AC 21 at 49-50

16 Civil Appeal No 6 of 1985. (20 July 1985).

17 At page 13

18 At page 14

(2)In determining total income, no deductions shall be allowed in respect of -

....

(b) any disbursements or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade, profession, employment or vocation of the taxpayer.

37. Section 19()1) of the *Income Tax Act 6 of* 1974, as well as the present Act, now reads:

(1)In determining total income, no deductions shall be allowed in respect of -

....

(b) any disbursements or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade, ***business***[19]***,*** *profession, employment or vocation of the taxpayer.*

38. Clearly the amendment of the law had some purpose. This group of words, "trade, business, profession, employment or vocation", all have quite distinctive settings.

39. Counsel for the Applicant suggested that the terms when grouped together in one cluster of words would have the same meaning or connectivity[20], "or they would be used inter-changeably to mean the same thing starting with a specific and broadening it to a catch all situation".[21] While I agree that the activities are all ones that taxpayers may engage in so as to pursue and derive income, I am not convinced, that their meaning can be so blurred as to be indistinguishable. A partner of a law firm, is not engaged in employment. A seasonal labourer working in a cane farm, is unlikely to be regarded as being a person engaged in a vocation.

---

19 My bold emphasis.

20 Presumably reliant on the latin maxim used for statutory construction, "noscitur a sociis".

21 See Supplementary Submissions of the Applicant dated 27 November 2011.

40. In my view, the trade in the present case is that of commercial printing.[22] The business refers to the actual commercial undertaking of Company B. At issue is whether the premiums so paid, were wholly and exclusively for the purposes of the business. The English case law, at least insofar it applies to companies is concerned, appears to have as its focus the business purposes of the taxpayer, even though the word "business" is not itself contained within the relevant provision. This position aligns itself in some ways with that of the Indian law,[23] where the term "business" is defined within Section 2 of that Act and incorporates the word trade.[24]

41. While this is not a pivotal point in my deliberations, it has nonetheless been one that I believe did warrant further submissions from the parties. Having regard to those submissions, the legislative history of the provision and the way it has subsequently been treated by the Courts of Fiji, I am content that the slight difference in these provisions, has no material bearing on these proceedings. Having said that, neither the Applicant, nor the Respondent provided the Tribunal with any reason for why this amendment came about. This may be an issue that on some future occasion, still needs to be clarified.

42. Counsel for the Applicant cited the case of *Strong & Co Ltd v Woodfield,*[25] as providing an appropriate starting point as to how the English courts have gone about the analysis of whether or not an expense is deductible. During closing submissions, Mr Bale also referred to the decision of Fatiake J, in *Sweetman v Commissioner of Inland Revenue*[26], where his Honour identified a two prong test, in which:

---

22 See analysis of what is a trade, as provided by Lord Reid in *Morgan v Tate & Lyle Ld* [1955]AC 21 at 47.

23 See *Income Tax Act* 1961

24 Interestingly here, the term "profession" includes "vocation".

25 [1906] AC448

26 [1993] FJHC 39 t

"Firstly the expenditure must be wholly and exclusively laid out or expended;

and

Secondly the expenditure must be "for the purpose of the trade profession (sic) ,business, employment or vocation of the taxpayer"

43. Counsel further referred to the decision in *Flour Mills,* where reliant on the judgment of Romer LJ, in *Bentley, Stokes & Lowless v Beeson*[27]*,* his Lordship said:

"the sole question is whether the expenditure in question was 'exclusively' laid out for business purposes that is: What was the motive or object on the minds of the two individuals responsible for the activities in question? It is well established that the question is one of fact."

44. In support of the Applicant's contention, that the English case law should be the primary source of reference when interpreting the meaning of Section 19(1)(b) of the Act, Mr Bale referred to the decision of *Bull v Commissioner of Inland Revenue (Majority Judgment)*[28] that confirms the legitimacy of tracing legislative history as a useful aid to statutory interpretation. I fully accept those submissions.

Submissions of the Respondent

45. Both within the written and oral submissions, Counsel for the Respondent, Ms Rayawa has persistently and correctly sought to differentiate the nature and purpose of the insurance policies the subject of this review. The first she referred to as the split purpose policy, the second, an endowment policy.

---

27 (1952) 2 All ER 82

28 [1999] FJSC 5

46. The Respondent's submissions pertaining to Section 19(1)(b) of the Act, had as their focus, the character of the expenditure and the intent of the parties at the time it incurred. In essence the Respondent's case is that the purpose of the policies taken out, was to strengthen and preserve the business organization and entity of the company.[29]

47. The Respondent relies on the case of *Sun Newspapers Ltd and Associated Newspapers Ltd v Federal Commissioner of Taxation*[30] as being as useful guide in determining which expenditure or outgoings may be referred to within the capital or the revenue account. The submission identifies the three matters identified by Dixon J, as being: -

    - *The character of the advantage sought, and in this its lasting qualities may play a part,*
    - *The manner in which it is to be used, relied upon or enjoyed, and in this and under the former head recurrence may play its part, and*
    - *The means adopted to obtain it; that is by providing a periodical reward or outlay to cover its use or enjoyment for periods commensurate with the payment or by making a final provision or payment so as to secure future use or enjoyment.*[31]

48. The submissions and evidence given by the Authority contend that if a premium paid on the insurance policy is capital, the expenses claimed would not be allowed as deductions under Section 19(1) of the Act, though neither would the proceeds of such policy, should they be treated that way, be taxable at a later date.

49. In relation to the request for clarification as to what was to be meant by the term "business", Ms Rayawa indicated it referred to an entity with the intention of the

---

29 See Closing Written Submissions of the Respondent at [25]. It is also noted that the Respondent has also identified the statutory purpose and made separate oral submissions on that point.

30 (1938) 61 CLR 337

31 Ibid at 363

making of profits. She submitted that the trade of Company B, was that of commercial printing.

50. In her closing submissions, Ms Rayawa said that the deductions should be disallowed for both policies as they were expenditure not used wholly or exclusively for business and were also capital in nature.

51. Ms Rayawa referred to the various Australian Taxation Office, *Income Tax Guidelines* that dealt with the treatment of keyman policies and life insurance policies. In the case of the Bula Life policy she asserted that as there was no break down of premiums for risk and investment, the expenditure should be deemed a capital payment. In the case of the Bula Scholar policy, reliant on the analyses provided for within *Sun Newpapers,* it was submitted that any endowment ultimately arising would be a payment not used as a profit making venture.

52. Insofar as the Applicant had admitted using the leverage of the Bula Scholar policy to secure bank funding for the purpose of developing an industrial park, Ms Rayawa opined that any such expansion and ultimate injection of funds, could not be regarded as being expended for the purpose of the trade, which she says, was "printing and packaging".

Relevant Considerations

53. There are clearly two different types of insurance policies the subject of this review application. Whether or not the premiums paid, should be treated as a deductible business case in each instances, is a matter for separate analysis.

<u>The Bula Life Policy</u>

54. While the purpose of the Bula Life insurance policy, was more akin to that of a key person scheme, the complete absence of any information pertaining to how the replacement costs of the "keyman" would be expended, both at the time that the policy was entered into and then in the submissions made by Company B to the

authority, make it more likely to be a keyman scheme in the mind of the Applicant only. The language of Mr K was quite clear in the giving of his evidence, the scheme was brought about to guard against creditors, liabilities and loans. None of these issues seem to directly relate to the revenue expenses associated with the replacement or loss arising out of the demise of the key person.

55. Even if it was the case that some of the proceeds were to be allocated to the replacement costs of its key man, there was no evidence whatsoever of the nature and scope for such provisioning.

56. In *The Commissioner of Inland Revenue v Flour Mills of Fiji Limited*[32]**,** the Court of Appeal observed that in assessing this question of purpose,

> *It turns the inquiry to the taxpayer's reason or reasons for making the expenditure and leads to the necessity to explore the taxpayer's mind to discover (the taxpayer's) intention or intentions up to the point of time when the expenditure was made"*

57. In the absence of any evidence of intention, the Supreme Court in *Sweetman v Commissioner of Inland Revenue*[33]*,* stated that "ascertainment of those purposes is a matter of inference". But this is not a situation where there is an absence of intention. The intention seemed quite clear. In the case of the Bula Life policy, it seemed to be a global attempt to ensure that the books of the company were protected by a significant bundle of funds that were not at any stage earmarked for any specific revenue expenditure purposes. Secondly, there was no information provided to the Respondent at any stage either at the reassessment process or at hearing, as to the duration of the loss adjustment period[34]. This to me seemed to suggest that the true workings of the 'keyman' scheme (at least as a justifiable

---

32 Civil Appeal No 6 of 1985; 20 July 1985 at pp17-18.

33 [1996] FJSC 3

34 That is, the period of time over which the revenue gained from the policy , serves to act as a substitute for the losses associated with the demise of the key person.

revenue expense) had not been thought through. From an accounting and taxation point of view, the replacement expenses that come about as a result of the demise of the key person, must also have some finite period in which they are incurred. It would be unrealistic to assume that a key person in an ongoing concern, would not ultimately be replaceable.[35]

58. During the conduct of the hearing, the Respondent classified this policy as a 'split purpose' policy. The presumption being, that the benefit of any proceeds would flow to the company and presumably the individual.[36] There is no evidence before the tribunal that Mr K would receive any personal benefit from the proceeds of this policy.[37] To that extent, it is not therefore accurate to refer to the policy as a split purpose policy. While I am satisfied that the purpose of the policy, was for the business, without more it is still difficult to understand as to how the payments could be regarded as ordinary business expenses. Though that is not the test. What is the test in the case of the Bula Life premiums, is whether the expenditure that was incurred, was doneso for the purpose of enabling Company B to carry on and earn profits in the (trade or) business.[38]

59. In my view, had Company B properly provisioned and identified the revenue expenses required to offset the demise of the keyperson, I would have been more encouraged to the prima facie view, that payments had met the requirements identified both in *Sweetman and Flour Mills,* as being expenditure wholly or exclusively for the purpose to carry on and earn profits in the business. But even if that had been the case, it is still difficult to see how the payment of those

---

35 This may be an issue that the Authority may wish to further consider, insofar as there may be a need to provide guidelines to taxpayers who contemplate both the taking out of such policies and the desire to seek their deductibility as expenses.

36 See for example the split purpose described in *Rydell Australia Pty Ltd v Federal Commissioner of Taxation* 99 ATC 2050.

37 Say for example, were Mr K to have contracted a defined illness as provided for within that policy.

38 See Lord Brightman's analysis in *Mallalieu v Drummond (Inspector of Taxes)* [1983] 2All ER 1095 at 1099; note also the reference made to this analysis within *Flour Mills* case at page 26.

premiums relating to a policy that may not be realised for 40 years (if at all), could be seen to be wholly or exclusively for that purpose.

60. While it is accepted that any subsequent monies received out of a matured or realised policy, could be deployed to enable the business to carry on and earn profits, that is not the test. The test should be applied in the context of the time (or financial year period) in which the expenditure was incurred. That is, at the time it is expended, does it have a purpose to enable the business to "carry on and earn profits"?

61. The emphasis should be on the words "carry on" and not on the words to earn profits. For it is more likely that the notion of earning profits, does not need to relate specifically to the consequence of the specific expenditure, but more to the broader charter of the profit making business.[39]

62. The words "carry on", seems suggestive of a state of affairs, where the expense contributes to that carrying on, rather than anticipating some later benefit to be derived as a consequence. It very well could be the case, that for many keyperson schemes, that no benefit ever flowed to the company to assist it to carry on, either because a subsequent decision was taken to surrender the policy, or the business was sold prior to the demise of its keyperson. In those cases, the payment of the premiums would have a purpose of nothing more, than to hedge against loss. Such a state of affairs, seemed akin to the intention of the Managing Director of Company B, who indicated that the purpose of taking out the policy, was to " guard against creditors, liabilities and loans".

63. It is for this reason, that the expenditure is therefore unlikely to be a deductible expense for the purposes of Section 19(1)(b) of the *Income Tax Act* (Cap 201).

[39] This is consistent with the views located and cited within *British Insulated,* where the Courts have recognized that there need be no direct relationship between expenses incurred and profits generated within a give financial year period..

64. It is also at this point where there is a convergence between the considerations relevant to Section 19(1)(b) and Section 19(1)(i) of the Act. The convergence arises when in ascertaining the nature of expense that has been incurred, consideration is given as to whether it was incurred to enable Company B to carry on and earn profits in the business, or whether it is had no purpose other than to protect and increase the capital assets. That is, whether or not, the expenditure was of a revenue or capital nature for the purposes of Section 19(1)(i) of the Act.

65. *British Insulated and Helsby Cables v Atherton*[40] provides a useful guide as to how historically questions of revenue and capital expenses have been distinguished. Consistent with the submissions of Mr Bale and as noted in the judgments of Viscount Cave and Lord Atkinson, care needs to be taken when resolving this question.

66. Both Counsel before me agree, that in the case of an assessment as to whether expenditure is revenue or capital in nature, a wider reference to Commonwealth authorities is permissible.

67. Viscount Cave LC, for example, cited the approach taken by Lord Dunedin in *Vallambrosa Rubber Co v Farmer*[41] , that characterised "in a rough way" a dichotomy where:

> *Capital expenditure is a thing that is going to be spent once and for all, and income expenditure is a thing that is going to recur every year*

68. This was not intended to be a prescriptive or universal formula. The purchase of a one off annuity in the *British Insulated* case, was one such case that did not conform to that rule.

---

40 [1926] AC 205

41 1910 S.C 519 at 525

69. Here in my view, the Australian case of *Sun Newspapers* provides a good framework for further assessment. As mentioned earlier, that framework deals with the character of the advantage sought; the manner in which it is to be used, relied upon and enjoyed and the means to obtain it.

70. In the present case, it remains a question of fact. In the absence of any evidence to the contrary and for the lack of specificity provided by Company B at any time, it is hard to otherwise contemplate the receipt of funds arising out of an insurance policy as being other than for the purposes of a capital injection. The premiums in such case do nothing other than pay for that anticipated event, be it the surrender of the policy at any stage, or the occurrence of an event to trigger payment of a capital sum. This cannot be regarded as an ordinary business expense.

71. The payment of the premiums for the Bula Life Scheme seem to be characterised as expenditure designed to enhance the capital standing of the business. It is an expense that is precluded from deduction, by virtue of Section 19(1)(i) of the Act.

<u>The Bula Scholar Policy</u>

72. The nature and purpose of the Bula Scholar policy was to leverage a capital loan out of Company B's bank, with a view to developing an industrial park. While Counsel for the Applicant, suggested that the purpose of this development was also to relocate the business to a new improved site, as the evidence of the Company Accountant when taken to Exhibit 8 revealed, the Company was to occupy only 402 square metres of the possible 19,630 total square metres of the total site area.

73. Mr K's evidence was that he was wanting to use the premium contributions to provide security to the bank for the development of the site. This expenditure was nothing more than to access capital. This policy in such a case is even less likely to be correctly characterised as a keyperson policy.

74. Having regard to the case law previously identified, my view is that the second policy must suffer the same fate. In my view the payments made under the Bula Scholar policy are somewhat analogous to those referred to by Nicholson J in *Gandy Timbers Pty Ltd v Federal Commissioner of Taxation*[42], where his Honour stated, "the premium outgoings are in the nature of a deposit akin to a savings bank deposit and consequently are an affair of capital".

75. This is clearly an expenditure of a capital nature for the purposes of Section 19(1)(i) of the Act. On that basis, I do not see the utility in exploring in detail whether or not the premiums would otherwise have met the test set out within Section 19(1)(b) of the Act. Based on the earlier analysis in the case of the Bula Life policy, such a characterisation would be even less likely. The expenditure for the payment of the Bula Scholar premiums, cannot be regarded as expenditure incurred for the purpose of enabling Company B to carry on and earn profits in the (trade or) business.

Conclusions

76. In my view the language of Section 19(1)b) of the Act is abundantly clear, insofar as it allows for the deduction of disbursements or expenses provided that these relate to monies wholly and exclusively laid out or expended for the purpose of the trade or business.[43] The 'purpose of the (trade or) business' must be given some further meaning or meanings. This meaning, is for the purpose of enabling a taxpayer to carry on and earn profits in the business.

77. What amounts to the purpose of the business of the taxpayer must be viewed on a case by case basis, having regard to the facts and the traditional approaches adopted by the courts. That approach is one that assumes expenditure is deductible where it

---

42 (1995)30 ATR 232 at 238

43 I confine the conclusion to those two terms, as it is unlikely that the analysis on these facts needed to be extended to consider the "profession, employment or vocation of the taxpayer".

is incurred for the direct purpose of enabling the business to carry on and produce profits.[44]

78. Monies expended for keyperson insurance policies, where they are designed specifically to meet the identifiable replacement costs and losses arising from the key person, may possibly be deductible in some circumstances.[45] Though for the reasons identified earlier, there are many problems envisaged in allowing such an approach, not the least of which would be in monitoring the provisioning for and realisation of revenue and the consequences that may otherwise flow, where a policy is surrendered or business sold.

79. Expenses incurred for the purpose of acquiring insurance policies, that later on are to be used for capital leverage or to secure unspecified capital injection at some later date (even if it derives from the life insurance of a nominal key person), would be capital expenditure.

80. The characteristics of the Bula Life policy, the intent of the Company at the time the policy was taken out and the absence of any cogent evidence to support the circumstances and purposes for which the scheme would in fact go to contributing to the specific replacement costs and expenses relating to the Managing Director, provides additional justification for that finding. In the case of the Bula Scholar policy, it is even less likely to be characterised as a keyperson policy and this is evident in the way in which both parties have attempted to describe its effect during the conduct of proceedings.

81. In the case of both policies, the premium payments are not deductible expenses by virtue of Section 19(1)(i) of the *Income Tax Act 1985* (Cap 201). They are also not deductible expenses for the purposes of Section 19(1)(b) of the Act. The Application for Review must therefore be dismissed.

---

[44] Despite the fact that on occasions, the means for achieving that purpose may be indirect.

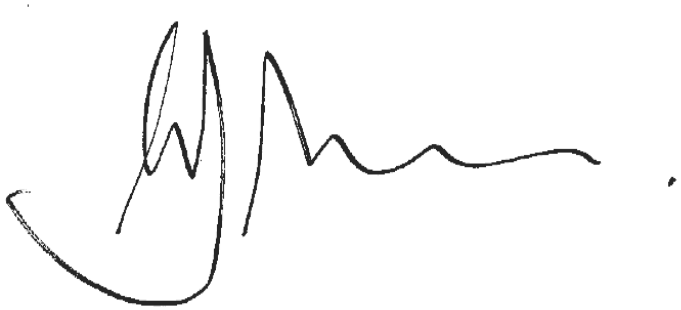
[45] A significant hurdle in reaching that position, would still remain whether the expenses are ones for the purpose of enabling the taxpayer to carry on and earn profits in the (trade or) business.

DECISION OF THE TRIBUNAL

82. The Tribunal orders:

(i) That the decision of the Respondent dated 2 June 2008 be affirmed.

(ii) That the parties are invited to make submissions in relation to costs within 28 days.



Mr Andrew J See
Resident Magistrate
28 November 2011