TAX BASICS FOR THE FINANCIAL SPECIALIST

Agenda

- Tax effect accounting basics
- COVID tax effects
- Non-resident reinsurance & withholding tax
- Other tax matters impacting finance teams
- General insurance – indirect tax perspective
- Underwriting – the formula (Taxes on Taxes)
- Issues with underwriting taxes
- Commission expense and GST – valid documentation
- Claims and GST – Division 11 vs Division 78 (very high level)
- Regulator Activity
- Other indirect tax matters

TAX EFFECT ACCOUNTING BASICS

	Income Tax Expense (P&L)	Deferred Tax Asset/ (Liability)	Current Tax Payable	Income Tax Expense (Equity)	Cash at bank
1 January opening balances	**-**	**400**	**(120)**	**-**	**2,000**
31 December OPBT 1,000	300		(300)		
Non-deductible perm diff 100	30		(30)		
Mvt deductible temp diff (P&L) 200		(60)	60		
Mvt non-deductible temp diff (Equity) 150		45		(45)	
Payment of prior year tax liability 120			120		(120)
PAYG instalments paid in current year 200			200		(200)
31 December closing balances	**330**	**385**	**(70)**	**(45)**	**1,680**

COVID TAX CONSIDERATIONS

- Recoverability of tax loss DTA
- Impacts of changing property strategy (AASB16, FVTPL, Lease surrender)
- Unrealised impairments of assets
- Available tax offsets and possible impacts to tax expense
- DTA impact on capital adequacy for APRA reporting
- PAYG Instalment Rate variations and impact on franking
- Insurance reserves (Indirect settlement costs, LAT adjustments)

NON-RESIDENT REINSURANCE & WITHHOLDING

- Non-resident reinsurance
  - When election made 3% tax is applied to reinsurance paid to non-residents
  - Based on gross premiums that are paid or credited
  - Relationship between GST and NRT
- Withholding tax
  - Interest, Dividend and Royalty payments

Interest	Dividend	Royalty
10%	30%	30%

** These % can be reduced by tax treaties, franked dividends or widely issued debt*

- Compensation payments on insurance claims

OTHER TAX MATTERS IMPACTING FINANCE TEAMS

- Fixed asset register (Division 40/43, balancing adjustments, inhouse software)
- IFRS17 impacts
- ATO activity
- Country by country reporting and Transfer pricing
- Interpretation 23 – uncertain tax positions
- M&A – it’s a good idea to get tax involved in advance

GENERAL INSURANCE – INDIRECT TAX PERSPECTIVE

- General Insurance in Australia is subject to multiple indirect taxes, both Federal and State Regulated
- Dependant on the state, there can be multiple layers of tax on top of the base premium
- Where applicable, Base premium is inclusive of any Terrorism Levy
- Most indirect taxes place the role of “tax collector” on the insurer – doing the job of the regulator in order to collect their taxes
- In total, indirect taxes, particularly in general insurance tend to dwarf the overall income tax liability of an organisation

UNDERWRITING – THE FORMULA

Base Premium (incl. Terrorism Levy) + Emergency Services Levy (where applicable) + GST + Stamp Duty = Total Premium Payable

- NSW Commercial property example

Base premium (incl. Terrorism)	$10,000	+
ESL @ 30.5%	$3,050	+
GST @ 10%	$1,350	+
Stamp Duty @ 9%	$1,291.95	=
Total Premium Payable by Customer	$15,646.95	

UNDERWRITING TAXES – THE ISSUES

- Significantly increases the cost of insurance to customers (previous example added more than 50% levy, tax and duty charges to base premium)
- Various state legislations and interpreting when and how it applies, particularly in relation to exemptions (eg. small business, charitable organisations, agriculture, life insurance etc)
- ESL in NSW – an absolute nightmare to get right and we could spend more than an hour just on this
- These are insurer taxes – if we don't collect correctly, the obligation doesn't change which in turn becomes an insurer cost
- Administratively burdensome with a heavy reliance on non-tax focussed areas of the business getting it right in order to meet compliance obligations. This creates sizeable internal costs to compliance

BROKER COMMISSIONS & DOCUMENTATION

- Intermediated business is largely cash settled on a net basis
  - Premiums *less* Commissions
- Insurers are reliant on broker closings to support GST recovery on the commission expenses they are charged
- Missing or incorrect broker closing's compromise insurers inclusion of input tax credit recovery on insurer BAS's
- Recipient Created Tax Invoices can reduce risk of recovering GST without holding valid documentation
- Issuing an RCTI requires both parties to the transaction to agree

CLAIMS & GST – DIVISION 11 VS DIVISION 78

- Recovery of GST in claims is captured under either Division 11 or Division 78 of the GST Legislation
- Division 11 is the broad GST recovery provision available to all GST registered businesses on their creditable acquisitions.
- Recovery of an input tax credit under Division 11 requires an acquisition to be made in the furtherance of your enterprise and be supported by valid documentation
- For insurance, a Division 11 ITC recovery occurs when an insurer makes an acquisition in it's own right in relation to a claim and has a valid tax invoice in it's or agents name to support the acquisition

CLAIMS & GST – DIVISION 11 VS DIVISION 78

- Division 78 is a dedicated insurance settlements section in the GST legislation.
- When an acquisition does not meet the criteria of Division 11, it falls within Division 78
- Typically used for reimbursements or settlements where there is NO acquisition made by the insurer
- ITC recovery is not the driver of Division 78 and therefore a valid tax invoice is not required
- A decreasing adjustment of up to $1/11^{th}$ of the payment may be available to the insurer dependant on the *insureds* ability to recover GST on the premium they paid for the policy
- Broadly, business customers would be expected to have full entitlement to recover GST on their premiums, therefore there is no decreasing adjustment available to insurers
- Conversely, personal lines customers (i.e mums and dads) would be expected to have no ability to recover the GST on their premiums, therefore a decreasing adjustment equal to $1/11^{th}$ of the payment is available to the insurer.
- As always, there are exceptions to the above (mixed business, GST free premium)

REGULATOR ACTIVITY

- ATO have increased their Justified trust regime to include GST with a significant focus on data and business systems
- State Governments continue to review and audit insurance duty – either holistically or issue specific
- NSW ESL has had a significant focus over the last 4 years with quite significant uncertainty as to the regime going forward
- Increased Global Activity and focus on consumption taxes and their contribution to the overall tax base