FROM:	Manager - International Tax, Taxation Department
LOCATION:	TAX/58/323
EXTENSION:	6860
DATE:	5 September 2000
REFERENCE:	TAX/MCM/hrc/Y2362
SUBJECT:	AUSTRALIA - GOODS AND SERVICES TAX
SUBJECT AREAS:	Australia
ACTION POINTS:	**To note the current position and discuss the effect of GST on premiums and claims relating to Australian coverholder business.**
DEADLINE:	**NOW**

1 Purpose

1.1 This is the third bulletin about the Goods and Services Tax ("GST") recently introduced in Australia. It updates underwriters and brokers on the current status of GST and supplements the earlier, more comprehensive, bulletins of 9 August 1999 and 22 March 2000.

2 Open Market Business

2.1 The Australian Taxation Office has now confirmed that open market business will not be subject to GST as Lloyd's Underwriters are not making a supply connected with Australia.

2.2 Underwriters are reminded that the impact of GST upon open market business is as follows:-

- Lloyd's Underwriters will not have to register for GST;
- GST will not have to be charged on premiums;
- no input tax credit will be allowed for claims;
- services supplied by Australian advisers to Lloyd's Underwriters, such as the services of lawyers and loss adjusters, will not be subject to GST as they will be treated as an export service; and

- services supplied by Australian brokers to Lloyd's Underwriters will not be subject to GST as they will be treated as an export service.

2.3 There is a reverse charge rule which requires an Australian insured that is input taxed (such as a bank or other financial institution) to account for GST on premiums paid to overseas insurers.

3 Coverholder Business - General

3.1 Keith Stern, Lloyds General Representative in Australia, has sent a further letter to coverholders giving details of a number of developments. A copy of this letter is attached as Appendix 1.

3.2 Please note that the calculation of the decreasing adjustment where there is an excess under the policy has changed and one of the examples given in Appendix 2 of the Market bulletin dated 22 March 2000 therefore needs amendment. Appendix 2 of this bulletin therefore replaces Appendix 2 of the bulletin dated 22 March 2000.

4 Readership and contact details

4.1 This bulletin is being sent to all active underwriters, managing agents and Lloyd's brokers.

4.2 If you have any queries, please contact me (on Lloyd's extension 6860) or Keith Stern (on 00 612 9223 1433).

Mrs M C McLeod
<u>Taxation Department</u>

Attachment

Appendix 1

25 August 2000

[Coverholders]

Dear [ ]

Australian Taxation Developments

A. Amendments to the Goods and Services Tax Legislation

Since I last wrote to you there have been a number of developments and amendments in the law regarding the application of the Goods and Services Tax (“GST”) to insurance.

The purpose of this note is not to provide an exhaustive summary of the changes; it is simply to draw them to your attention.

A detailed explanation is contained in the 3rd edition of the ICA’s GST booklet of July 2000. You should contact the ICA if you would like to obtain a copy of this publication.

1 Time of notification of Input Tax Credit entitlements by Insured

Under the GST law, an insured is only required to notify an insurer of the extent to which the insured could claim an input tax credit for a premium at or before the time a claim is first made under an insurance policy since the last premium was paid, whether or not the policy covers a period spanning 30 June 2000.

Insurers may nevertheless require such information before inception in order to price the cover.

(You will recall that the legislation previously provided that this notification was to be made at the time that the policy was supplied, or before 30 June 2000 if the policy was supplied prior to that date.)

2 Calculation of decreasing adjustment where insured pays an excess

An example of the calculation of the decreasing adjustment under the revised rules where the insured pays an excess to the insurer in a cash settlement scenario is attached to this letter. This should be regarded as a replacement of Appendix 2 of the Market Bulletin dated 22 March 2000.

The changes to the calculation of the decreasing adjustment are intended to correct what was seen by the Government as an unintended error. Previously excesses were not affected by the uplift factor that is applied in determining the decreasing adjustment for an insurer in relation to the settlement of a claim where the insured was not entitled to a full input tax credit in relation to the premium.

For other scenarios, for example, where the excess is paid directly to a third party, refer to the various examples in the Appendix to the ICA GST booklet.

3 Insurance settlements involving the supply of goods or services

The Australian Taxation Office has issued a draft ruling (GSTR 2000/D19) regarding non-cash settlements and the interaction between a claim for input tax credits for the GST included in costs incurred by an insurer in settling a claim and the decreasing adjustment mechanism under Division 78.

At section 7.8 of the Market Bulletin dated 22 March 2000 there is a table outlining the consequences for the insurer where:

- a cash settlement is made; or
- a payment is made to a third party for goods and services.

The general effect of the draft ruling issued by the ATO is that the column "payment for goods/services" will only apply where the insurer:

- chooses the supplier;
- instructs the supplier about the supply; and
- enters into a contractual relationship with the supplier.

Where goods are provided to the insured, the statements in that column will also apply if the insurer obtains title to the goods before supplying the goods to the insured.

If these conditions are not met, for example because the insurer merely reimburses the insured for costs incurred by the insured, the amount paid by the insurer will be treated in the same manner as under the column headed "cash settlement".

The ATO has issued an "Insurers supplement to the Business Activity Statement Instructions" which provides practical examples of the application of the principles in the ruling, and guidance as to the disclosure of items on a Business Activity Statement (i.e. your GST return). A copy of these instructions is available on the ATO's website "www.taxreform.ato.gov.au".

4 GST free insurance

There have been technical amendments to the GST legislation that extend the circumstances where the supply of insurance to a non-resident outside Australia will be GST free.

There have also been amendments to the legislation relating to the scope of the marine and aviation cargo insurance that will be GST free.

In broad terms, insurance in relation to the international transport of goods will now be GST-free in the following circumstances:-

- The insurance relates to the transport of goods from their "place of export" in Australia to a destination outside Australia (unchanged);
- The insurance relates to the transport of goods from a place outside Australia to their place of "consignment" in Australia. GST-free status will also extend to insurance of the subsequent transport of the goods within Australia as long as it is an *integral* part of the

transport from outside Australia to the place of consignment in Australia and to the loading and handling of the goods within Australia that is part of the transport.

Whether the subsequent transport is "integral" will be a question of fact. The Government has suggested that if goods are unpacked from a container, any subsequent transportation of them will not be integral and hence insurance in relation to that leg of the journey will be subject to GST.

(Under the previous rules, insurance in relation to the subsequent transport of goods from the place of consignment in Australia would have been subject to GST, as would insurance in relation to loading and handling in Australia).

- The insurance relates to the transport of goods from a place outside Australia to that place or another place outside Australia (unchanged).

There have also been rules introduced to clarify any GST liability on personal travel insurance where there is a mix of domestic and international cover.

A draft ruling issued by the Australian Taxation Office -GSTR 2000/D14-provides additional guidance.

B. Division 15 tax

There is some interaction between GST and the Division 15 income tax that should be calculated on the premiums paid to Lloyd's Underwriters. The current rate of income tax is 3.4%, although it will reduce to 3% with effect from the commencement of the 2002 income year (usually 1st July 2001).

The ATO has confirmed that in determining the premium on which Division 15 income tax is calculated:

a) stamp duty should be excluded;

b) GST should be excluded; and

c) fire brigade levies should be included.

Also, we have obtained confirmation from the ATO that the new PAYG instalment system will not change the current arrangements for the payment of the Division 15 income tax.

C. Open Market Business

The Australian Taxation Office has now confirmed that open market business will not be subject to GST as Lloyd's Underwriters are not making a supply connected with Australia.

As always, we will endeavour to keep you informed as further developments emerge. Please contact me on (02) 9223 1433 if I can be of any assistance in the meantime.

Yours sincerely

Keith Stern
Lloyd's General Representative in Australia

Appendix 2

Replacement

(This replaces Appendix 2 to Lloyd's letter of 24 March 2000 to recognise amendments to the GST legislation)

Coverholder business - Illustration of decreasing adjustment calculations

The aim of "decreasing adjustments" is to place the GST administration of paid claims entirely in the hands of insurers. The decreasing adjustment is calculated using formulae seeking to ensure that only the business margin (ie. premiums less paid claims) is subject to GST.

The following illustrates the GST consequences of a cash settlement where an insured is only partially entitled to an input tax credit on premiums. The table in section 7.8 of the market bulletin illustrates the more common scenarios.

There is a two step formula for calculating the decreasing adjustment.

In the following, ITC% is the extent to which the insured was entitled to claim an input tax credit in relation to the associated premium, expressed as a decimal.

1. Calculate the "settlement amount"

Settlement amount = [The amount of money paid less the sum of any excess paid to the insurer] x $\frac{11}{(11 - \text{ITC\%})}$

2. Calculate the decreasing adjustment

The decreasing adjustment is then:

Settlement amount x $^{1}/_{11}$ x [1 - ITC%]

Example 1 - No Excess

Assume that:

- the insured is entitled to claim an input tax credit of 60% of the GST payable in relation to the premium; and
- a loss is suffered by the insured that is covered by the policy to which the notification relates and the insured needs to receive $1,040,000 after GST in order to be fully compensated for this loss.

	$	Insured	$
Insurer			
Settlement	1,040,000	Settlement	1,040,000
Decreasing adjustment - reduces GST liability	(40,000)		
Net Cost	1,000,000	***Net cash received***	1,040,000

The insured will not be liable to pay GST and the insurer will not be entitled to an input tax credit.

However, the insurer will have a "decreasing adjustment" (ie. an adjustment decreasing their GST liability) of $40,000, calculated as follows:

Note that "Settlement" and "Settlement Amount" are quite distinct concepts. "Settlement" refers to the amount paid to the insured in settlement of a claim, whereas "Settlement Amount" is an amount calculated by reference to a formula in the GST legislation.

Settlement Amount

$$= \text{Settlement} \times \frac{11}{(11 - \text{ITC\%})}$$

$$= \$1{,}040{,}000 \times \frac{11}{(11 - 0.6)}$$

$$= \mathbf{\$1{,}100{,}000}$$

Decreasing Adjustment

= ***Settlement amount*** x $^{1}/_{11}$ x [1 - ITC%]

= $1,100,000 x $^{1}/_{11}$ x [1 - 0.6]

= **$40,000**

Example 2 - Excess

Assume same facts as in Example 1. However, in this case, the insured is required to pay an excess of $10,000 to the insurer.

Insurer	$	**Insured**	$
Settlement	1,040,000	Settlement	1,040,000
Decreasing adjustment - reduces GST liability	(39,615)		
Excess	(10,000)	Excess	(10,000)
Net Cost	990,385	***Net cash received***	1,030,000

The insured will not be liable to pay GST and the insurer will not be entitled to an input tax credit.

However, the insurer will have a “decreasing adjustment” (ie. an adjustment decreasing their GST liability) of $39,615, calculated as follows:

Settlement Amount

$$= \text{(Settlement less excess)} \times \frac{11}{(11 - \text{ITC\%})}$$

$$= (\$1{,}040{,}000 - \$10{,}000) \times \frac{11}{(11 - 0.6)}$$

= **$1,089,423**

Decreasing Adjustment

$= \{\textbf{\textit{Settlement amount}} \times {}^{1}/_{11} \times [1 - \text{ITC\%}]\}$

$= \{\$1{,}089{,}423 \times {}^{1}/_{11} \times [1 - 0.6]\}$

= **$39,615**