FROM:	Manager – International Tax, Taxation Department
LOCATION:	TAX/58/323
EXTENSION:	6860
DATE:	22 March 2000
REFERENCE:	TAX/MCM/hrc/Y2265
SUBJECT:	AUSTRALIA – GOODS AND SERVICES TAX
SUBJECT AREA(S):	Australia
ATTACHMENTS:	Appendices 1, 2 & 3
ACTION POINTS:	**To note the current position on GST on premiums and claims relating to Australian coverholder business and to review pricing**
DEADLINE:	**Now**

1 Purpose

1.1 The purpose of this bulletin is to advise underwriters and brokers as to the current status of the proposed Goods and Services Tax ("GST") in Australia. It outlines the administration of the tax and notes that the Australian Competition and Consumer Commission is policing the effect of its introduction on the pricing of goods and services.

2 Introduction

2.1 The market bulletin dated 9 August 1999 explained that GST will apply from 1 July 2000. The original legislation has been amended following consultation with the Insurance Council of Australia.

2.2 However, a number of issues remain unresolved and further information will be provided as it becomes available.

2.3 The legislation, as it now stands, provides that:

- GST at the rate of 10% will apply to insurance and reinsurance premiums where the insurance is connected with Australia (with a small number of exceptions);

- Special rules apply to foreign insurers, including Lloyd's Underwriters, which generally place the responsibility for accounting for the tax on the Australian coverholder or insured;

- There are a number of transitional arrangements which apply to policies which span 1 July 2000 and to claims incurred before that date;

- Commission and fees may be subject to GST depending on the nature of the supply, although commission for services to Lloyd's Underwriters will be free from GST.

2.4 Section 3 of this bulletin explains how GST affects open market business and sections 4 to 9 set out the position for binding authority business ("coverholder business"), that is business which is bound under Australian coverholder binding authorities. Section 10 explains the role of the Australian Competition & Consumer Commission in monitoring premium increases as a result of the introduction of GST.

3 Open market business

3.1 As advised in the earlier bulletin, it is believed that open market business (including lineslips and business placed under a UK broker's world-wide binding authority) will not be subject to GST as Lloyd's Underwriters are not making a supply connected with Australia. It is hoped that written confirmation of this will be received shortly from the Australian Taxation Office.

3.2 Subject to this confirmation, the impact of GST upon open market business will be 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 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.

3.3 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 with a small number of exceptions.

3.4 Lloyd's Underwriters will not be able to claim an input tax credit for GST suffered on goods and services forming part of a claim. For registered insureds, who can claim an input credit for this GST, the net cost of claims should not increase. For a non-registered insured, the cost of claims may increase as the indemnity will need to cover the GST charged on goods and services, although the impact of GST on goods may be offset by the abolition of wholesale sales tax.

4 Coverholder Business - General

4.1 As outlined in the previous market bulletin, business written under Australian coverholder binding authorities will generally be subject to GST as the role of the coverholder is such that the Lloyd's Underwriters are making a supply that is effectively connected with Australia. Certain policies will not be subject to GST (see section 6).

4.2 Coverholders will need to register for GST and will be responsible for accounting for GST on binding authority business to the Australian Taxation Office as if they were the insurers they represent.

4.3 Lloyd's Underwriters will need to discuss the effect of GST with their coverholders and should consider adjusting premiums to take into account the impact of GST on both premiums and claims.

5 Coverholder Business - Supplies

5.1 The supply of insurance and associated services can involve a number of supplies for GST purposes:

- the supply of insurance by the insurer to the insured;
- the supply of services by a broker/intermediary to the coverholder;
- the supply of services by the coverholder to Lloyd's Underwriters;
- the supply of administrative services by the broker/intermediary and/or coverholder to the insured.

5.2 Each supply must be looked at separately for GST purposes. Coverholders' records will need to identify and account for GST on the different supplies even though for cash purposes they may be 'netted off'. Separate tax invoices will also be needed for each supply that is subject to GST, as described in section 9.

5.3 The treatment of each of the supplies is as follows:

The supply of insurance

Business written under binding authorities will generally be subject to GST (subject to the exceptions described in section 6).

The supply of services by an Australian broker or other intermediary

The broker/intermediary is making a supply to the coverholder that will be subject to GST.

The supply of services by the coverholder

The services supplied by a coverholder to Lloyd's Underwriters is an export service and will not be subject to GST.

Administrative services provided by coverholders and/or brokers/intermediaries to insureds

These administrative services, for which a fee is paid, will be subject to GST.

5.4 Appendix 1 gives a number of examples which illustrate the GST treatment of these supplies.

6 Coverholder Business - GST-free insurance

6.1 Coverholders should note that certain types of insurance will be free from GST.

6.2 In broad terms, travel insurance relating to international travel will not be subject to GST. Marine and aviation cargo insurance, predominantly related to the exports from and imports into Australia, will also be free from GST. Discussions are taking place between the Australian Taxation Office and the Insurance Council of Australia to agree the scope of these GST free supplies.

6.3 The supply of insurance that is directly connected with goods or property situated outside Australia will also be free from GST. For example, a policy issued to an Australian business covering a building located in New Zealand would not be subject to Australian GST.

6.4 The supply of insurance to persons outside Australia for risks outside Australia will not be subject to GST. This will include, for example, a policy covering an Australian company and its foreign subsidiaries. The premium attributable to the foreign subsidiaries in respect of non-Australian risks will not be subject to GST.

6.5 The Australian GST rules also provide that life insurance is free from GST. For these purposes, 'life insurance' is only insurance written by a life insurer. This means, for example, that a personal accident policy containing a life element will be subject to GST. Coverholders will be aware that Lloyd's Underwriters are not licensed to write life business in Australia.

7 Coverholder Business - Payment of Claims

7.1 Under the original proposals:

- insurers were to obtain an input tax credit for 1/11th of a paid claim; and
- insureds would be subject to GST on the paid claim if they claimed an input tax credit for the associated premium.

7.2 This approach has now been modified so that:

- insureds will not be liable to GST on a paid claim (subject to 7.4 below);
- insurers will not be entitled to an input tax credit; and
- insurers will be entitled to a so-called 'decreasing adjustment' where the insured was not entitled to a full input tax credit in relation to the associated premium. The 'decreasing adjustment' is simply a form of input tax credit.

7.3 GST is designed to be a tax on the business margin. In the insurance industry this margin is the excess of premiums over claims. Both the original proposal and the modified approach achieve this.

7.4 At the time of settlement of a claim, the entitlement of the insurer to a credit will depend on:

- the original notification by the insured to the insurer as to the insured's entitlement to an input tax credit; and
- the actual entitlement at the time of payment of the claim.

The interaction of any change of entitlement between these two times will determine the insurer's credit and is yet to be resolved between the Australian Taxation Office and the Insurance Council of Australia. If the insured understates his or her entitlement to an input tax credit they may be liable to pay GST on a claim settlement.

7.5 Where the policy was not subject to GST (eg a travel policy solely in relation to international travel), no credit can be claimed for the paid claims.

7.6 Where the policy was partially subject to GST (eg a policy covering properties in Australia and overseas), a credit will only arise if the paid claim relates to the portion of the policy that was subject to GST. For example, if a claim is paid in connection with the property situated outside Australia, there will be no credit for the insurer (see example 3 in Appendix 2).

7.7 For insureds, other than those entitled to a partial input tax credit, the payment of an excess will not have an impact on the insurer's credit calculation, the only impact being to reduce the cost of settling the claim. Example 2 in Appendix 2 provides an example where there is an excess for an insured with partial entitlement.

7.8 The practical implications for a policy that has been fully subject to GST are set out in the table below.

The consequences vary depending upon:-

- whether the insured is registered for GST purposes;
- the extent to which the insured was entitled to claim an input tax credit for the GST included in the premiums for the policy under which the claim is paid; and

- the manner in which the claim is settled. For example, does the insurer simply provide a cash sum to the insured (including cash provided by way of reimbursement of costs incurred by the insured) or does the insurer purchase goods or services (such as paying for repairs) and provide these to the insured.

	Insurer	
Type of Insured	***Cash Settlement***	***Payment for Goods/Services***
(i) Unregistered for GST purposes; or (ii) Registered for GST purposes and not entitled to any ITC on premium	Credit = 1/11th of cash settlement	A credit can be claimed for the GST included in the cost of the goods/services
Registered for GST purposes and entitled to full ITC on premium	No credit	A credit can be claimed for the GST included in the cost of the goods/services
Registered for GST purposes and entitled to partial ITC on premium	There is a formula for calculating the credit in this case which involves two steps. The formula and a number of examples illustrating their operation are set out in Appendix 2.	A credit can be claimed for the GST included in the cost of the goods/services
Credit = Input tax credit or decreasing adjustment.		

8 Coverholder Business - Transitional Rules

8.1 Where a supply is made that spans 1 July 2000, consideration will need to be given to the operation of the transitional rules. This may mean that GST will be payable soon after 1 July 2000 in relation to supplies that were paid for prior to 1 July 2000.

Supply of Insurance

8.2 Where a period of cover spans 1 July 2000, that part of the premium relating to the cover after 1 July 2000 will be subject to GST. The GST will be payable by the coverholder soon after 1 July 2000.

Input tax credits for insureds

8.3 As a portion of premiums spanning 1 July 2000 will be subject to GST, insureds may be able to claim an input tax credit for the GST component of the premiums. Insureds will need a ‘tax invoice’ in order to do this (see section 9).

8.4 For policies spanning 1 July 2000, insureds will also need to notify insurers on or before 30 June 2000 of the extent to which they are entitled to claim an input tax credit. GST may be payable by insureds on a claim settlement if this notification is not made (see section 7.4)

Claims Payments

8.5 Neither input tax credits nor decreasing adjustments can be claimed by insurers in relation to paid claims where the insured event occurred prior to 1 July 2000. However, the cost of settling these claims may be impacted by GST (for example, the cost of purchasing a replacement good or acquiring services, such as those of a repairer, will include GST).

8.6 Commissions and brokerage paid to brokers and intermediaries by coverholders would generally be treated as an up-front payment for the introduction of the business, unless the agreement provides otherwise.

8.7 Where a fee for services rendered to an insured is not an upfront fee and is for services that are provided over a period spanning 1 July 2000, that portion relating to the period after 30 June 2000 will be subject to GST and, provided the coverholder receives a tax invoice, a corresponding input tax credit can be claimed.

9 Coverholder Business - Tax Invoices

9.1 The party acquiring goods and services needs a 'tax invoice' in order to claim an input tax credit for the GST included in the cost of goods and services.

9.2 It is therefore important that a tax invoice is issued in relation to every supply that is subject to GST. No tax invoice is required if the supply is GST-free (e.g. no tax invoice is required in relation to the supply of services by a coverholder to Lloyd's Underwriters)

9.3 An insured that is registered for GST purposes will need a tax invoice in order to claim a GST input tax credit for the GST included in the premium.
The Australian Taxation Office has issued a draft ruling stating that an insurance renewal notice will become a 'tax invoice' upon payment of the premium by the insured provided the notice meets all other requirements.

9.4 A coverholder will also need a tax invoice in order to claim a GST input tax credit in relation to commission paid to an Australian broker or other intermediary.

9.5 In prescribed circumstances the coverholder or the insured (i.e. the acquirer of the services) may issue the invoice itself (referred to as a 'recipient created tax invoice').

10 Australian Competition & Consumer Commission (ACCC)

10.1 The Australian Government is concerned that consumers should benefit fully from reductions in indirect taxes, where that is the effect of the new tax changes, and that they should not be exposed to greater than necessary price rises. To this end the Trade Practices Act has been amended to create a new office of "price exploitation" in relation to the new tax changes.

10.2 The level of penalties for breaches reflects the Government's concern to ensure that no business takes unfair advantage of the relevant new tax changes. There are pecuniary penalties of up to $10 million for corporations and $500,000 for individuals for breaches of the new provisions.

10.3 The Trade Practices Act covers a number of other matters and prohibits, for example, arrangements or understandings between competitors that have the purpose or effect of fixing, controlling or maintaining prices, misleading and deceptive conduct, and false or misleading representations in relation to the prices of goods or services.

10.4 The ACCC has been given new powers and responsibilities in connection with the new tax changes and price exploitation, including powers to investigate complaints and to obtain information about prices and pricing decisions.

10.5 The ACCC has also published Guidelines about when prices contravene the prohibition of price exploitation. The Guidelines are available from the ACCC's GST website at http://gst.accc.gov.au.

10.6 Underwriters and coverholders should familiarise themselves with the relevant provisions of the Trade Practices Act and the ACCC Guidelines and consider whether they need to obtain their own advice.

11 Conclusion

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

11.2 Underwriters need to consider the effect of the Australian GST with the Australian coverholders in order to ensure that they meet their Australian tax obligations. Keith Stern, Lloyd's General Representative in Australia is writing to Australian coverholders and a copy of his letter is attached as Appendix 3.

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

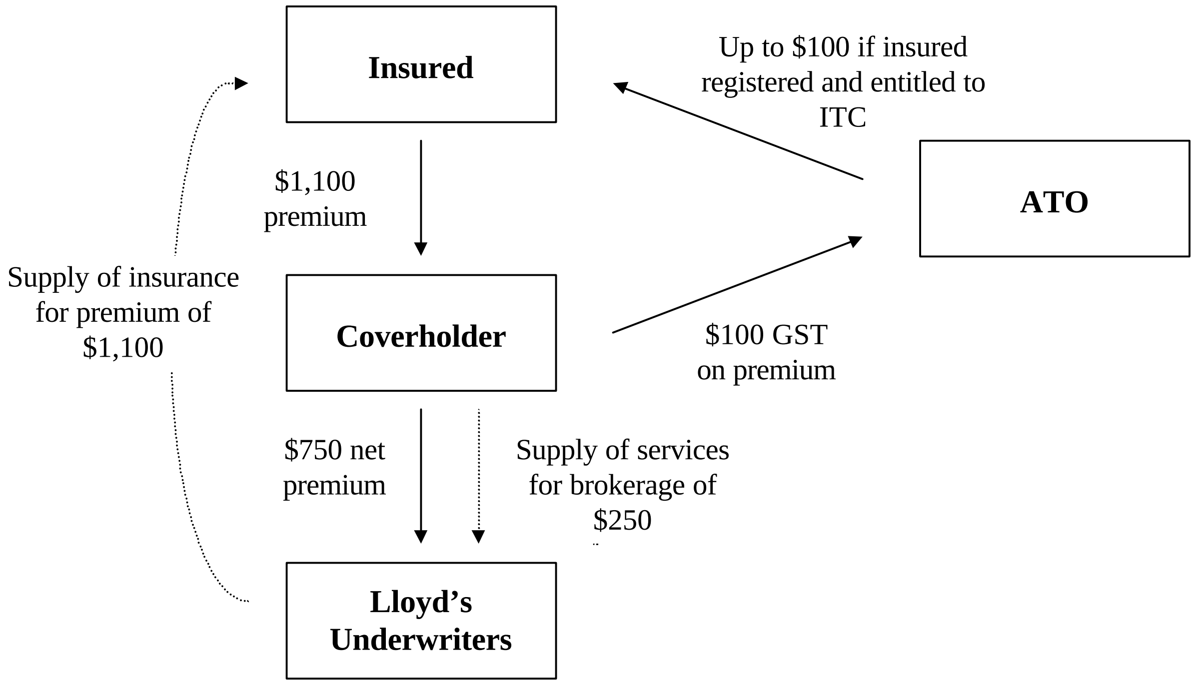
Mrs M C McLeod
Taxation Department

Appendix 1

Coverholder business - Illustration of supplies

Example 1

- Premium = $1,100 (inclusive of GST) or $1,000 (exclusive of GST). Stamp duty has been ignored in this example.
- Brokerage is 25% of the GST exclusive premium.

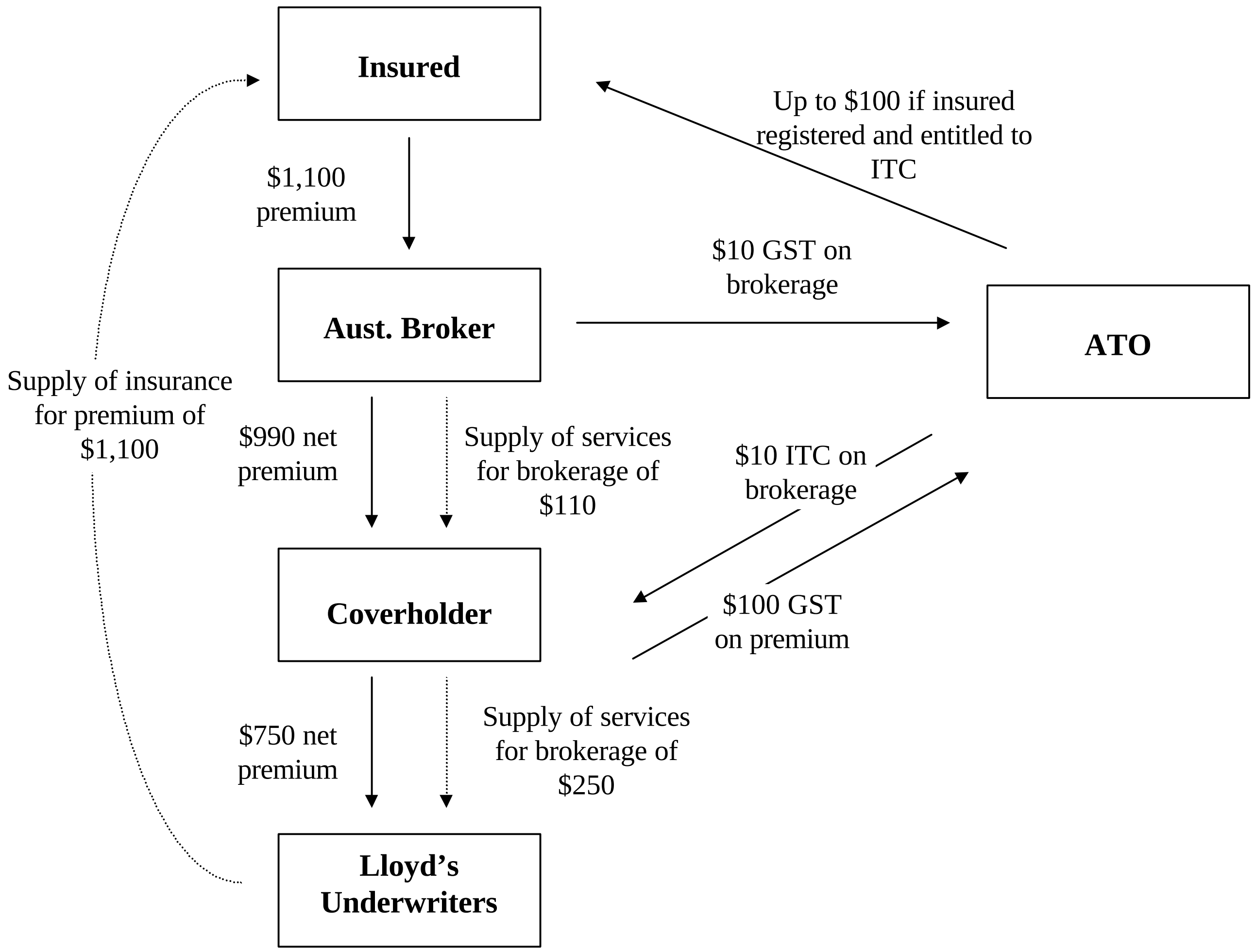


Notes

- = cash flow
  = supply of services
- Prior to the introduction of GST, only a premium of $1,000 would have been charged for the Lloyd's Underwriters to receive a $750 premium after commissions.
- The supply of services by the coverholder (for which the coverholder receives brokerage of $250) to the Lloyd's Underwriters is not subject to GST. It is an export service.

Example 2

- Premium = $1,100 (inclusive of GST) or $1,000 (exclusive of GST). Stamp duty has been ignored in this example.
- Brokerage is 25% of the GST exclusive premium. The coverholder uses this brokerage to pay brokerage of $110 to an Australian broker or other intermediary (this represents a 15/10 split of the brokerage).



Notes

- = cash flow
  = supply of services
- Prior to the introduction of GST, only a premium of $1,000 would have been charged for the Lloyd's Underwriters to receive a $750 net premium.
- The provision of services by the Australian broker or other intermediary to the coverholder is subject to GST.
- The supply of services by the coverholder (for which the coverholder receives brokerage of $250) to the Lloyd's Underwriters is not subject to GST. It is an export service.

Appendix 2

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 (i.e. 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"***

$$\text{Settlement amount} = \text{The amount of money paid} \times \frac{11}{(11 - \text{ITC\%})}$$

<u>Less</u> the sum of any excess paid to the insurer

2. ***Calculate the decreasing adjustment***

The decreasing adjustment is then:-

Settlement amount x 1/11 x [1 - ITC%]

Example 1

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.

Insurer	$	Insured	$
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" (i.e. an adjustment decreasing their GST liability) of $40,000, calculated as follows:-

Settlement Amount

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

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

= **$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

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	(30,000)		
Excess	(10,000)	Excess	(10,000)
Net cost	1,000,000	***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” (i.e. an adjustment decreasing their GST liability) of $30,000, calculated as follows:-

Settlement Amount

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

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

= **$1,100,000**

Decreasing Adjustment

= {Settlement amount x 1/11 x [1 - ITC%]} - Excess

= {$1,100,000 x 1/11 x [1 - 0.6]} - $10,000

= $40,000 - $10,000

= **$30,000**

Example 3

An insured takes out a policy that relates to buildings in both Australia and New Zealand. Twenty per cent of the risk relates to the New Zealand buildings. Therefore, only 80% of the premiums will be subject to GST.

The insured makes a claim in relation to damage to a building in New Zealand and receives a cash settlement of $1,000,000.

The insurer will not be entitled to any credits (input tax credits or decreasing adjustments) in relation to the paid claim.

TEXT OF LETTER TO LLOYD'S COVERHOLDERS

Dear

Goods and Services Tax

Following on from the meetings held with coverholders and Maureen McLeod of Lloyd's Taxation Department last month, I have provided below some comments in relation to the main issues discussed at the meetings.

You will appreciate that whilst all care has been taken in preparing these comments, they are intended to be informative and cannot be regarded as a substitute for legal advice.

This is a particularly important point for you as the GST law places the legal responsibility on you to properly account for the GST in respect of business written under your binding authority.

A copy of a Market Bulletin recently issued to Lloyd's Underwriters on 22 March 2000 and a handbook issued by the Insurance Council of Australia ("ICA") in relation to "GST & The General Insurance Industry" dated February 2000 are attached for your information.

The ICA handbook provides some more detailed commentary in relation to issues such as the requirements for a valid tax invoice (refer section 8) and the GST treatment of commissions and brokerage (refer section 9).

1 Registration

1.1 Each coverholder is required to register for GST purposes as an agent for Lloyd's Underwriters even if its own annual turnover or its Lloyd's annual premium income is less than $50,000.

1.2 All GST in relation to Lloyd's coverholder business and the input tax credits arising from paid claims in relation to Lloyd's coverholder business should be amalgamated with GST payable and input tax credits claimable by the coverholder for all its business activities and returned on a single Business Activity Statement.

1.3 The legislation requires coverholders to account for all GST and input tax credits monthly, rather than quarterly.

This is because the entire Lloyd's coverholder business in Australia is taken into account in determining the tax period. Discussions are being held with the Australian Taxation Office in order to determine whether quarterly reporting may be available in appropriate circumstances.

1.4 It is understood that the coverholder's own Australian Business Number ("ABN") should be used for all GST purposes so that a separate ABN will not be required by a coverholder in relation to Lloyd's coverholder business. Confirmation is being obtained from the Australian Taxation Office.

1.5 As an aside, from 1 July 2000 the party paying for a supply will need to withhold tax at the rate of 48.5% if the party making the supply has not quoted an ABN in relation to the supply, irrespective of whether the person making the supply is registered for GST purposes.

2 Timing of GST liability

2.1 GST is payable for the earlier of the period in which consideration is received or an invoice is issued. The receipt of consideration by a broker will trigger the coverholder's liability to GST. However, the coverholder will not necessarily be aware of these supplies until the broker advises the coverholder of the premiums collected. This advice may be made <u>after</u> the coverholder is required to complete a GST return for the relevant period.

2.2 The Australian Taxation Office has issued a draft ruling which provides that where the broker acts an agent for the coverholder, the coverholder will only be liable to pay GST on supplies made through the broker in relation to the tax period when the coverholder is first notified by the broker that the supply has been made.

2.3 The ICA is discussing the impact of this ruling with the Australian Taxation Office in order to ascertain when "notification" takes place in an insurance context.

3 Stamp Duties

3.1 GST will be imposed on premiums exclusive of stamp duty.

3.2 The State Governments have not yet advised whether stamp duties will be applied to the GST-inclusive or GST-exclusive premiums.

4 Fire Brigade Levies

4.1 The contribution made by insurance companies to meet the cost of fire brigades will not be subject to GST.

4.2 However, the fire brigade levy components of premiums (in relation to policies issued in some States) will be subject to GST.

5 Australian Competition & Consumer Commission ("ACCC")

I draw your attention to the role of the ACCC in controlling prices in relation to the introduction of GST as outlined in the attached market bulletin.

6 Outstanding issues

Despite the best efforts of the ICA and others, there are still a number of issues surrounding GST and the insurance industry generally that have not been resolved. A copy of the circular from the ICA dated [March 2000] identifying the outstanding issues is attached for your information.

* * * * *

I understand the importance of this major reform upon your business and I will keep you informed as further information comes to hand. In the interim, if I can be of any assistance, please contact me on (02) 9223 1433.

Yours sincerely

Keith Stern

Lloyd’s General Representative in Australia