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Dear Mr Broderick

## CONSOLIDATION INTEGRITY MEASURES

The Insurance Council of Australia<sup>1</sup> (the Insurance Council) appreciates the opportunity to comment on the exposure draft legislation, *Treasury Laws Amendment (2017 Measures No. 9) Bill 2017* (the Bill). This submission focuses on the deductible liabilities measure (the Measure) under Part 1 of the Bill, which seeks to remove a 'double tax benefit' that may arise with certain deductible liabilities held by an entity that joins a consolidated group.

We understand that the measure seeks to remove the possible double benefit by generally excluding deductible liabilities of a joining entity from the entry allocable cost amount (ACA) calculation that a consolidated group performs in setting the tax cost of the joining entity.

### Inconsistent treatment of deductible insurance liabilities

The Insurance Council is concerned with the Measure's inconsistent treatment of deductible liabilities which are unique and integral to the commercial operation of the insurance industry; that is, the treatment of the Outstanding Claims Liability (OCL), Indirect Claim Settlement Costs (ICSC) and the Liability Adequacy Test (LAT) – notwithstanding that the ICSC and LAT are part of the OCL.

The Measure would operate to exclude the ICSC and LAT deductible liabilities acquired by a consolidated group from the ACA calculation, thereby reducing the ACA for the joining entity by the value of those deductible liabilities. We note, that the measure would permit the OCL to continue to be included as part of the ACA calculation for general insurers, as provided for under the exemption in subsection (1AC) of the Bill.

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<sup>1</sup> The Insurance Council of Australia is the representative body of the general insurance industry in Australia. Our members represent more than 90 percent of total premium income written by private sector general insurers. Insurance Council members, both insurers and reinsurers, are a significant part of the financial services system. June 2017 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross written premium of \$45 billion per annum and has total assets of \$124.9 billion. The industry employs approximately 60,000 people and on average pays out about \$135 million in claims each working day.

Insurance Council members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers insurance).

However, the exclusion of the ICSC and LAT liabilities from the exemption in the Bill would create a number of practical and costly adverse effects, which would contradict the Government's objective of the consolidation integrity measures to, among other things, "remove anomalous tax outcomes when an entity leaves or joins a tax consolidated group"<sup>2</sup>.

### **Detrimental impact of the measure**

The exclusion of the ICSC and LAT liabilities from calculation of the ACA would result in a reduced ACA being allocated to the assets of a joining entity. This could inadvertently distort the allocated ACA to the underlying assets of a joining entity and give rise to unintended taxable gains on assets held to meet short term insurance liabilities after its acquisition by the consolidated group. (The majority of assets held by general insurers are usually in cash and investments to support insurance liabilities.) Indeed, any increased tax cost arising from the measure could ultimately be passed on to policy holders by way of higher insurance premiums, which would be inconsistent with the policy objectives of the Bill.

Additionally, the measure may have a negative impact on the solvency requirements of an insurer for prudential regulation purposes, as set by the Australian Prudential Regulation Authority. Specifically, should the ICSC not be included in the ACA as an insurance-related liability, any increased assessable amount without a corresponding deduction may negatively impact the solvency calculation of an insurer and could become an undesirable impediment to any future restructuring activities (e.g. via a merger or acquisition).

### **Suggested approach to mitigate against anomalous tax outcomes**

While the Insurance Council appreciates that the Bill provides an exemption for certain general insurance liabilities to help limit distortions, the exemption should be extended to include all general insurance-related liabilities, such as the ICSC and LAT, in order to comprehensively mitigate against inadvertent distortions and anomalous tax outcomes.

Additionally, in support of our suggested approach, the Insurance Council notes that in its final report of its post-implementation review of certain aspects of the consolidation tax cost setting process<sup>3</sup>, the Board of Taxation suggested that a general carve-out – without limitation to the OCL – should also exist for general insurance liabilities.

The Insurance Council has seen a fuller, more detailed examination of the Measure which we understand KPMG has provided to this consultation process. We agree with this analysis which strongly supports extension of the exemption within the Bill to include the entire accounting OCL balance (without reduction for LAT and ICSC).

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<sup>2</sup> The Minister for Revenue and Financial Services, the Hon Kelly O'Dwyer MP, 11 September 2017, [media release](#).

<sup>3</sup> The Board of Taxation, April 2013, 'Post implementation review of certain aspects of the consolidation tax cost setting process: A [Report](#) to the Assistant Treasurer'. Pages 15-17 refer.

If you have any questions or comments in relation to our submission, please contact John Anning, the Insurance Council's General Manager Policy, Regulation Directorate, on tel: (02) 9253 5121 or email: [janning@insurancecouncil.com.au](mailto:janning@insurancecouncil.com.au).

Yours sincerely



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