Insurance Tax Highlights – Asia Pacific

Australia

August 2014

In this article, we highlight some of the key income tax developments affecting the insurance industry in Australia. It covers:

Peter Kennedy
Tax Partner
PwC Australia

Tel: +61 2 8266 3100
Email: peter.kennedy@au.pwc.com

Darren Mack
Tax Director
PwC Australia

Tel: +61 2 8266 0993
Email: darren.mack@au.pwc.com

Samuel Lee
Tax Director
PwC Australia

Tel: +61 2 8266 9218
Email: samuel.g.lee@au.pwc.com

Ronita Aghakhan
Tax Manager
PwC Australia

Tel: +61 2 8266 2306
Email: ronita.aghakhan@au.pwc.com

1. Recent Australian Taxation Office activity relating to outstanding claims liabilities;
2. Amendments to the thin capitalisation regime;
3. Amendments to exemptions relating to dividends received from a foreign resident company;
4. FATCA;
5. Common Reporting Standards.

Outstanding Claims Liability

In 2013, the Australian Taxation Office (ATO) issued questionnaires to several large insurance companies (who together represent 55% of the industry based on gross written premiums) regarding the appropriateness for tax purposes of the level of probability of adequacy (PoA) adopted for outstanding claims liabilities (OCL). In addition, the ATO engaged in broader industry consultation with the intention of releasing further guidance.

The PoA in respect of an insurance company's outstanding claims liability is generally set at 75% or above for accounting purposes and is typically adopted for tax purposes. In addition based on information shared by the ATO some insurers adopted a PoA as high as 90 – 95% for tax purposes.

For tax purposes in Australia, movements in the OCL each year are generally brought to tax as assessable or deductible (excluding indirect settlement costs). Hence, changes in the PoA have a direct impact to the tax position of an entity.

The ATO had also included OCL related questions in client risk reviews for some insurance companies. However, we understand that the ATO has discontinued pursuing this issue as they have indicated that the matter is subject to broader industry review. At this stage, and consistent with the industry's historical approach, the ATO appears to have accepted the adoption of the OCL for tax purposes as that used for accounting purposes (subject to certain timing adjustments such as indirect settlement costs) calculated under the Australian accounting standards (AASB 1023). This is also worth noting for Australian branches of foreign insurers which may not be required to prepare separate financial statements in Australia, but will nevertheless also be required to calculate the OCL in accordance with the Australian accounting standards.

As part of the consultation process, the ATO has agreed to come back to the industry with details of actions/options and some finality on the ATO view in a paper which is proposed to be released prior to November 2014.

Thin Capitalisation Regime

The thin capitalisation regime broadly applies to disallow debt deductions (interest) where the debt funding levels of an entity are considered excessive.

As previously announced by the Australian Government on 6 November 2013, the thin capitalisation rules are to be tightened to prevent erosion of the Australian tax base. The bill containing these changes was introduced into the House of Representatives on 17 July 2014. The key amendments include the following:

- the *de minimis* threshold will be increased from $250,000 to $2 million of debt deductions;
- the safe harbour debt limit for general entities (non-authorised deposit taking institutions (ADI)) will be reduced from 3:1 (75% of adjusted assets) to 1.5:1 (60% of adjusted assets) on a debt-to-equity basis;
- the world-wide debt limit for outward investing entities (non-ADI) will be reduced from 120 per cent to 100 per cent of the gearing of the entity's worldwide group; and
- a new in-bound worldwide gearing debt limit will be introduced.

These amendments are proposed to apply from incomes years commencing on or after 1 July 2014 (1 January 2015 for December year ends).

Please note that for insurance companies, the amount of debt may nevertheless be restricted by the capital requirements imposed by the prudential regulator.

Foreign dividend exemption

Dividends received by an Australian resident company from a foreign resident company (in which the Australian resident company holds an interest of at least 10%) are generally not taxable in Australia.

Changes to these "exemptions" were introduced in the same bill containing the thin capitalisation amendments discussed above. Broadly, the proposed amendments are as follows:

- The exemption will be restricted to non-portfolio returns (including non-share dividends) on "equity interests" rather than basing the exemption on interests with voting rights under the current rules. Significantly, this means that some securities that are equity in form but debt in substance will no longer qualify for the exemption;
- Corporate entities will be able to benefit from the non-portfolio exemption where they receive distributions through interposed entities such as trusts and partnerships; and
- Other entities that are taxed as corporates such as public trading trusts, corporate unit trusts and corporate limited partnerships who receive a distribution will now also be eligible for the exemption.

Foreign Account Tax Compliance Act

On 28 April 2014, the Federal Treasurer announced that Australia and the United States of America (US) had signed an intergovernmental agreement (IGA) to reduce the burden on Australian financial institutions in complying with the US Foreign Account Tax Compliance Act (FATCA) regime. In addition, legislation has been passed through Parliament enacting the terms of the IGA into domestic law.

Australian financial institutions including insurance companies now have clarity regarding their obligations under FATCA, and in particular, whether they fall within the regime. Insurance companies that are "specified insurance companies" may have significant obligations under the FATCA rules. Specified insurance companies are defined as "any entity that is an insurance company (or holding company of an insurance company) that issues or is obligated to make payments with respect to a Cash Value Insurance Contract or an Annuity Contract". Broadly, the rules are designed to target insurance companies with policies with investment like features which may present a risk of US tax evasion (noting there are specific exclusions for superannuation/pension type business).

General insurance companies that only write risk business would not typically meet the definition of a specified insurance company as they would not usually write Cash Value Insurance or Annuity Contracts. Life insurance companies may be specified insurance companies depending on the types of policies they issue. An insurer that is a specified insurance company will be required to perform due diligence on its policy holders, register on the US IRS portal and report on "specified US persons" as applicable.

Common Reporting Standard

The Australian Government released in June 2014 a Discussion Paper: *Common Reporting Standard for the automatic exchange of tax information* seeking views regarding the timing, implementation and cost of compliance for financial institutions. The Common Reporting Standard for the automatic exchange of tax information (CRS) was previously endorsed by G20 Finance Ministers and Central Bank Governors at their meeting on 22 and 23 February 2014. Often labelled as the "global" FATCA, the CRS is designed to increase global transparency through increased due diligence and reporting on certain "reportable accounts" in order to combat tax evasion. The Australian Government has yet to make any final decisions on the implementation of the CRS in Australia. If adopted, these rules (which are broadly modelled on FATCA) may impact certain insurance companies.

For more information, please contact the following territory tax partners:

Country	Partner	Telephone	Email address
Australia	Peter Kennedy	+61 2 8266 3100	peter.kennedy@au.pwc.com
China	Matthew Wong	+86 21 2323 3052	matthew.mf.wong@cn.pwc.com
Hong Kong	Rex Ho	+852 2289 3026	rex.ho@hk.pwc.com
India	Nitin Karve	+91 22 6689 1477	nitin.karve@in.pwc.com
Indonesia	Margie Margaret	+62 21 5289 0862	margie.margaret@id.pwc.com
Japan	Nobuyuki Saiki	+81 3 5251 2570	nobuyuki.saiki@jp.pwc.com
Korea	Hoon Jung	+82 2 709 3383	hoonjung@samil.com
Malaysia	Phaik Hoon Lim	+60 3 2173 1535	phaik.hoon.lim@my.pwc.com
New Zealand	David Lamb	+64 9 355 8419	david.lamb@nz.pwc.com
Phillipines	Malou P. Lim	+63 2 459 2016	malou.p.lim@ph.pwc.com
Singapore	Yoke Har Yip	+65 6236 3938	yoke.har.yip@sg.pwc.com
Taiwan	Richard Watanabe	+886 2 2729 6704	richard.watanabe@tw.pwc.com
Thailand	Prapasiri Kositthanakorn	+66 2 344 1228	prapasiri.kositthanakorn@th.pwc.com
Vietnam	Dinh Thi Quynh Van	+84 4 3946 2231	dinh.quynh.van@vn.pwc.com

This content is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.

© 2014 PricewaterhouseCoopers Limited. All rights reserved. PwC refers to the Hong Kong member firm, and may sometimes refer to the PwC network. Each member firm is a separate legal entity. HK-20140811-3