Worked example

Value of the net risk component of life insurance policies when a life insurance company joins or leaves a consolidated group

Description

Movements in the value of a life insurance company's net risk component of life insurance policies are reflected in the calculation of the company's taxable income in accordance with Division 320 of the *Income Tax Assessment Act 1997* (ITAA 1997).

To ensure that appropriate amounts are bought to account for the head company's core purposes for the income year in which a life insurance company joins or leaves a consolidated group, and for the entity core purposes in the income year in which the life insurance company leaves, sections 713-511 and 713-565 of the ITAA 1997 apply to determine the value of these liabilities for the purposes of Division 320.

This example demonstrates the values that need to be taken into account.

Commentary

Where the value of a life insurance company's liabilities under the net risk component of life insurance policies is less at the end of an income year than at the end of the previous income year, the difference is included in the company's assessable income. → paragraph 320-15(1)(h), ITAA 1997

Conversely, where the value of those liabilities at the end of an income year is greater than at the end of the previous income year, the difference is allowable as a deduction. → section 320-85, ITAA 1997

Under section 713-505 of the ITAA 1997, the head company of a consolidated group that has a subsidiary member that is a life insurance company at any time during the income year will also be taken to be a life insurance company for that income year for income tax purposes. Consequently, paragraph 320-15(1)(h) and section 320-85 of the ITAA 1997 apply in calculating the head company's taxable income during that income year..

For the income year in which a life insurance company joins a consolidated group, and where the head company does not already carry on life insurance business, the head company's value of the net risk component of life insurance policies at the end of the previous income year is taken to be the joining life insurance company's value of net risk component of life insurance policies at the joining time. → section 713-511

For the income year in which a life insurance company joins a consolidated group and the head company already carries on a life insurance business, the value of the net risk component of life insurance policies at the end of the previous income year includes the joining life insurance company's value of these liabilities at the joining time. → section 713-511

For the income year in which a life insurance company leaves a consolidated group, and the head company does not itself carry on life insurance business, the head company is treated as if the value of its liabilities under the net risk component of life insurance policies include the leaving life insurance company's value of the net risk component of life insurance policies at the leaving time. → subsection 713-565(3)

If the head company continues to carry on life insurance business, the value of the net risk component of life insurance policies at the end of the income year will include the leaving life insurance company's value of the net risk component of life insurance policies at the leaving time. → subsection 713-565(3)

In determining the taxable income of the leaving life insurance company for the income year in which it leaves the consolidated group, the value of the net risk component of life insurance policies at the end of the previous income year will be taken to be the value of the liabilities, for the life insurance company, at the leaving time. → subsection 713-565(4)

Example 1

Facts AeeCo, the head company of a consolidated group, acquires all the membership interests in ElleCo, a life insurance company, during the 2005-06 income year. AeeCo did not carry on a life insurance business before acquiring ElleCo. The value of ElleCo's net risk component of life insurance policy liabilities at the joining time is $40 million. At the end of 2005-06, AeeCo's value of the net risk component of life insurance policy liabilities is $90 million.

For the purposes of applying section 320-85, under section 713-511 the value of AeeCo's net risk component of life insurance policy liabilities at the end of the 2004-05 income year is taken to be $40 million. Consequently, AeeCo is entitled to a deduction for $50 million under section 320-85.

Example 2

Facts BeeCo, the head company of a consolidated group, acquires all the membership interests in ElleCo, a life insurance company, during the 2005-06 income year. BeeCo carried on a life insurance business before acquiring ElleCo. The value of ElleCo's net risk component of life insurance policy liabilities at the joining time is $10 million. The value of BeeCo's net risk component of life insurance policy liabilities at the end of the 2004-05 income year was $20 million. At the end of 2005-06, BeeCo's value of the net risk component of life insurance policy liabilities is $5 million.

For the purposes of applying paragraph 320-15(1)(h), under section 713-711 the value of BeeCo's net risk component of life insurance policy liabilities at the end of 2004-05 is taken to be $30 million. Therefore, under paragraph 320-15(1)(h), BeeCo's assessable income will include $25 million.

Example 3

Facts

ElleCo, a life insurance company, leaves the consolidated group headed by CeeCo during the 2005-06 income year. CeeCo does not carry on life insurance business after ElleCo leaves. The value of ElleCo's net risk component of life insurance policy liabilities at the leaving time is $7 million. The value of these liabilities at the end of CeeCo's 2004-05 income year was $10 million. The value of ElleCo's net risk component of life insurance policy liabilities at the end of 2005-06 was $12 million. The income tax consequences are as follows:

For CeeCo: $3 million is included in assessable income in accordance with paragraph 320-15(1)(h). Under subsection 713-565(3) the value of the liabilities at the end of 2005-06 is taken to be $7 million.

For ElleCo: $5 million is allowed as a deduction in accordance with section 320-85. Under subsection 713-565(4) the value of the liabilities at the end of 2004-05 is taken to be $7 million.

References

Income Tax Assessment Act 1997:

- Division 320
- paragraph 320-15(1)(h)
- section 320-85
- section 713-505
- section 713-511
- section 713-565
- subsection 713-565(3)
- subsection 713-565(4)

Explanatory Memorandum to the Tax Laws Amendment (2004 measures No.7) Bill 2004

Revision history

Section C9-6-540 first published 15 November 2006.

Proposed changes to consolidation

Proposed changes to consolidation announced by the Government are not incorporated into the *Consolidation reference manual* until they become law. In the interim, information about such changes can be viewed at:

- **http://assistant.treasurer.gov.au** (Assistant Treasurer's press releases)
- **www.treasury.gov.au** (Treasury papers on refinements to the consolidation regime).