

TD 96/D15 - Income tax: in what circumstances can an employer who self-insures for workers' compensation obtain a deduction for provisions under subsection 51(1) of the Income Tax Assessment Act 1936 ?

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This document has been finalised by TD 97/14.

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Draft Taxation Determination

Income tax: in what circumstances can an employer who self-insures for workers' compensation obtain a deduction for provisions under subsection 51(1) of the *Income Tax Assessment Act 1936*?

1. In *ANZ Banking Group Limited v. F C of T* 94 ATC 4026; (1994) 27 ATR 559 the taxpayer was a 'self-insurer' under the *Accident Compensation Act 1985* (Vic) ('the compensation Act'). As such, it was required to make payments to injured employees in accordance with the provisions of that Act. In its 1986 income tax return, the taxpayer claimed a deduction in respect of its estimated workers' compensation liabilities for:

- (a) accident claims which had been reported but not paid ('RBNP'); and
- (b) accident claims which had been incurred but not reported by injured employees ('IBNR').

2. The Commissioner's practice (as set out in Taxation Ruling IT 2098) had been to deny deductions for such provisions and allow deductions in the year of income when the payments were actually made to the injured employees.

3. The Full Federal Court considered that the compensation Act created a presently existing liability to make payments in the future from the moment an employee suffers an injury at work. Such a liability, though perhaps ultimately defeasible, is still a liability 'incurred' within the meaning of subsection 51(1) of the *Income Tax Assessment Act 1936* ('the Act'). Accordingly, the Court held that a deduction is allowable in the year in which the liability arises notwithstanding that the actual payments are not made until a later year.

4. In view of the decision of the Court (as it applies to workers' compensation claims) the Commissioner will allow similar claims by self-insurers for workers' compensation liabilities under subsection 51(1) in the following circumstances:

- (a) where employers are entitled to self-insure under their relevant workers' compensation/workcare legislation; and
- (b) the relevant workers' compensation/workcare legislation operates so as to fix the liability on an employer at the time the accident occurs; and
- (c) where provisions comprising the claim under subsection 51(1) are capable of reasonable estimation.

In relation to (c), the provisions should be bona fide and acceptable to the company's auditors to enable certification as a true and fair view of the company's accounts.

5. A matter that is not entirely clear from the decision in the *ANZ* case is the correct taxation treatment of provisions made by parent companies in respect of their liability under section 143 of the compensation Act to make payments to employees of their subsidiary companies. Hill J stated (at ATC 4036, ATR 573):

'... The deductions must, however, be reduced to reflect the fact that the estimates relate not only to claims of the Bank but also to claims of its subsidiaries.'

The Court did not give reasons for this aspect of its decision. Section 143 of the compensation Act provides that:

'Where a worker or a worker's dependants are entitled to compensation under this Act and the worker's employer was, at the time of the injury -

(a) a body corporate that was at that time a self-insurer; or

(b) a body corporate that was at that time a subsidiary of a self-insurer -

the first mentioned body corporate is, ... liable to pay the compensation.'

Whilst the matter is not free from doubt, in the circumstances of a statutory scheme that covers a corporate group, we are prepared to accept that such provisions are deductible to the parent company.

6. We understand, however, that some subsidiary companies with Victorian employees have made provisions in their own accounts in respect of those employees notwithstanding that the liability rests with their parent company. Given that the decision in the *ANZ* case is that the parent company has a presently existing pecuniary obligation to make payments for both 'RBNP' and 'IBNR' claims at the time an employee of a subsidiary is injured, the subsidiary could not be entitled to a deduction for provisions in respect of the same amounts. If the parent company has not claimed a deduction for such provisions and the subsidiary, in fact, makes payments when they are due, a deduction will be allowable to the subsidiary in the year in which the payments are made.

7. Amendment of prior year income tax returns to give effect to the decision in the *ANZ* case will be allowed in accordance with section 170 of the Act.

8. As those taxpayers seeking amendments will be changing from a payment basis to an accruals basis, the High Court decision in *Country Magazine Pty Ltd v. FC of T* (1968) 117 CLR 162; (1968) 15 ATD 86 will apply. No deduction is allowable for claims outstanding at the close of the year immediately prior to the transitional year which are payable in the transitional or later year(s). To the extent that the amount actually payable in a later year is greater than the amount of the estimated liability for that period, a deduction will be available for the difference. See *Commonwealth Aluminium Corporation Ltd v. FC of T* 77 ATC 4151; (1977) 7 ATR 376.

9. Taxation Ruling IT 2098 will be withdrawn on finalisation of this draft Taxation Determination.

Commissioner of Taxation

16 October 1996

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Related Determinations:

Related Rulings: IT 2098

Subject Ref: insurance; self-insurance; workers compensation

Legislative Ref: ITAA 51(1); ITAA 170

Case Ref: *ANZ Banking Group Limited v. FCT* 94 ATC 4026; (1994) 27 ATR 559; *Commonwealth Aluminium Corporation Ltd v. FC of T* 77 ATC 4151; (1977) 7 ATR 376; *Country Magazine Pty Ltd v. FC of T* (1968) 117 CLR 162; (1968) 15 ATD 86

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