TD 97/14 - 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?

Australian Taxation Office

Taxation Determination TD 97/14

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 Ltd v. FC of T* 94 ATC 4026; (1994) 27 ATR 559 ('the *ANZ* case'), the taxpayer was a 'self-insurer' under the *Accident Compensation Act 1985* (Vic). 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 *Accident Compensation Act 1985* (Vic) creates 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 ITAA'). 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. The Court also held that the provisions for such deductions should be *bona fide*, capable of reasonable estimation and acceptable to the company's auditors to enable certification as a true and fair view of the company's accounts.

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) of the ITAA 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) the calculation of the provision is made with regard to the relevant principles set out in Taxation Ruling IT 2663 (Basis of Assessment of General Insurance activities) and Taxation Ruling TR 95/5 (Basis of Assessment of Reinsurance Activities).

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 *Accident Compensation Act 1985* (Vic) 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 related 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 *Accident Compensation Act 1985* (Vic) 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. Requests for 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 ITAA. Any change from a payment basis to an accruals basis means that 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.

8. Alternatively, in view of the Commissioner's stance in Taxation Ruling IT 2098, taxpayers will not be required to amend prior year income tax returns to give effect to the decision in the *ANZ* case. The application of the decision may be made in the current year, i.e., the year commencing 1 July 1996 (or the equivalent substituted accounting period). Taxpayers who choose this approach will only be required to change their basis of lodging returns from a payment basis to an accruals basis prospectively. Claims in respect of which liability arose in a year of income which commenced prior to 1 July 1996 (or the equivalent substituted accounting period) may be continued on a payment basis in accordance with Taxation Ruling IT 2098. An accruals basis will be required for all workers' compensation claims arising in a year of income commencing on or after 1 July 1996 (or the equivalent substituted accounting period).

9. Taxation Ruling IT 2098 continues to apply to those taxpayers who choose to adopt the approach outlined in paragraph 8. That is, its application will now be limited to payments which are referable to liabilities which arose in a year of income which commenced prior to 1 July 1996 (or equivalent substituted accounting period).

Commissioner of Taxation
18 June 1997

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