GSTR 1999/D6 - Goods and Services Tax: payment of fees and commissions to insurance brokers and agents where the period of insurance cover begins before and ends on or after 1 July 2000

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Generated on: 23 November 2026, 10:58:49 PM

Draft Goods and Services Tax Ruling

Goods and Services Tax: payment of fees and commissions to insurance brokers and agents where the period of insurance cover begins before and ends on or after 1 July 2000

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Preamble

This document is a draft for industry and professional comment. As such, it represents the preliminary, though considered, views of the Australian Taxation Office. This draft may not be relied on by taxation officers, taxpayers and practitioners, as it is not a ruling or advice in terms of section 37 of the ***Taxation Administration Act 1953****. When officially released it will be a public ruling for the purposes of section 37 and may be relied upon by any person to whom it applies.*

What this Ruling is about

1. This Ruling discusses whether a fee paid to a broker for insurance services or a commission paid by an underwriter (insurance company) to a broker or agent is:

- consideration for a one-off supply; or
- a supply made for a period or progressively over a period, where the period of insurance cover begins before and ends on or after 1 July 2000.

(See section 12 of the *A New Tax System (Goods and Services Tax Transition) Act 1999* ('the Transition Act')).

2. This Ruling also explains which refundable and non-refundable fees and commissions paid to insurance brokers and insurance agents before 1 July 2000, are subject to section 12 of the Transition Act.

Date of effect

3. This Ruling, when finalised may be relied upon on or after 8 July 1999 (the date of Royal Assent to the Goods and Services Tax ('GST') legislation).

Background

4. A payment of a fee or commission to an insurance intermediary (a broker or agent) is usually a single payment for services that the intermediary renders 'up-front'.

5. Up-front activities include (but are not limited to):

- gaining an understanding of the business of the client and assessing the client's insurance needs including meetings with clients, preparation of survey reports and valuations, and liaison with other professional advisers;
- obtaining insurance quotes from the market place and comparing the relative merits and pricing of these quotes;
- assessing the policy wordings of the various policies being offered;
- reporting back to the client on all of the above activities and receiving the client's instructions;
- obtaining policy documents from insurers and passing them on to clients; and
- issuing invoices, collecting premium payments and accounting for them to the insurer.

6. Generally, the intermediary undertakes these activities before any payment of a fee or commission. Also, a broker is sometimes asked by the insured to provide assistance with claims or general insurance advice after the policy is arranged.

7. Under the terms of most insurance arrangements, fees and commissions paid to the broker or agent are not refunded when an insurer or insured cancels a policy.

Ruling

8. A non-refundable fee paid to a broker or an agent for services is consideration for a one-off supply. It is not for a supply made for the period of insurance cover or made progressively throughout the period of the insurance cover. This is the case unless an agreement with the insurance intermediary indicates otherwise.

9. Also, a non-refundable commission paid to a broker or an agent for arranging a policy is consideration for a one-off supply. It is not for a supply made for the period of insurance cover or progressively throughout the period of the insurance cover. This is the

case unless an agreement with the insurance intermediary indicates otherwise.

10. However, if a fee or commission is partly or fully refundable, section 12 of the Transition Act applies to the extent that there is a requirement or a reasonable expectation the insurance services will be supplied after 1 July 2000. The supply of the insurance services (under a policy commencing before 1 July 2000 and ending on or after that date) is subject to the GST, to the extent that the broker or agent is required or reasonably expected to supply services after 30 June 2000 (see paragraphs 25 and 26).

11. If a fee or commission is fully refundable or partly refundable, the supply of the insurance services (under a policy commencing before 1 July 2000 and ending on or after that date) is subject to the GST, to the extent that the insurance intermediary is required or reasonably expected to supply services after 30 June 2000.

12. In particular, for refundable fees and commissions, the terms of the agreement or arrangement determine whether it is consideration for a one-off supply, or alternatively a supply made for the period of insurance cover or progressively throughout the period of insurance cover.

Explanations (this forms part of the Ruling)

Insurance brokers and insurance agents

13. Insurance brokers and insurance agents negotiate contracts of insurance, place risks or arrange insurances for other persons. They also play a role in making and settling claims under insurance policies. Their activities are regulated by the *Insurance (Agents and Brokers) Act 1984* ('the IAB Act') which defines an insurance broker as:

> 'a person who carries on the business of arranging contracts of insurance, whether in Australia or elsewhere, as agent for an intending insured.'[1]

14. An insurance broker is an intermediary acting on behalf of the insured except when acting under a 'binder' which is an authority given by an underwriter to enter contracts of insurance on behalf of the underwriter or to settle claims on behalf of the underwriter.[2] Insurance brokers generally act as independent professional consultants.

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[1] IAB Act - section 9.
[2] IAB Act - section 9.

15. The term 'insurance agent' is not defined in the IAB Act. However, 'insurance intermediary' is defined[3] to mean a person who:

> '(a) for reward; and
>
> (b) as an agent for one or more insurers or as an agent for intending insureds,
>
> arranges contracts for insurance in Australia or elsewhere, and includes an insurance broker.'

16. A 'commission' is remuneration (usually expressed as a percentage of the premium or sum insured) payable by the insurance company to the broker or agent for their services. It is also known as brokerage when paid to a broker. Commission does not include fees or charges payable directly by an insured to a broker for the broker's services. Examples include a flat service fee, a policy administration charge, a further percentage of premium or a charge on the basis of time expended.

17. The intermediary's service can be viewed as:

- a one-time supply of arranging the cover between the insured and the underwriter;
- a supply made for the period of the insurance cover; or
- a progressive supply made over the course of the insurance cover.

The Transition Act

18. Provisions that apply to agreements and arrangements that span the implementation date of GST on 1 July 2000, are contained in the Transition Act. For most policies, a supply of insurance cover is made for a period or progressively over a period. Accordingly, the question of whether the supply of services by the intermediary in arranging that cover is made for the period, or progressively over the period of the cover arises under the Transition Act.

19. Section 6 of the Transition Act deals with the time of supply or acquisition for the purposes of that Act. Subsection 6(4) states that:

> 'A supply or acquisition of services is made when the services are performed.'

20. Where the intermediary is a broker who provides a service to the client and charges a fee for this service, subsection 6(4) requires that the supply or acquisition of the broker's service is made when the broker performs those services. When a supply under subsection 6(4) has occurred, consideration must be given to whether the service or

[3] IAB Act - section 9.

arrangement spans 1 July 2000. GST is only payable on a supply or service to the extent that it is made on or after 1 July 2000.[4]

21. Section 12 of the Transition Act deals with progressive or periodic supplies and provides that:

> '(1) This section applies if:
>
> (a) you make a supply under an agreement, or an enactment, that provides (expressly or impliedly) that the thing supplied is to be supplied:
>
> (i) for a period; or
>
> (ii) progressively over a period;
>
> whether or not at regular intervals; and
>
> (b) that period begins before 1 July 2000 and ends on or after 1 July 2000.
>
> (2) For the purposes of this Act, the supply is taken to be made continuously and uniformly throughout that period.
>
> (3) For the purposes of this section, a supply by way of lease, hire or similar arrangement is taken to be a supply for the period of the lease, hire or arrangement.'

22. To apply section 12, you must determine whether the supply by the intermediary is for the period of the insurance cover or is delivered progressively over the period of the insurance cover. In particular, the treatment of the intermediary's fee and commission on cancellation of a policy may affect the possible application of subsection 12(1). This is based on the reasonable assumption that fees and commissions that are non-refundable imply that at least some, if not all, of the agreed insurance services have already been provided by the broker or agent.

Treatment of fees and commissions on cancellation

23. The three ways an intermediary can treat fees and commissions on cancellation are:

(a) no refund of the fee to the insured or commission to the insurer;

(b) a partial or pro rata refund of both the fee and commission made to both the insured and insurer; or

(c) a combination of (a) and (b).

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[4] Transition Act – section 7.

No refundable amount

24. Fees and commissions represent remuneration to the intermediary for undertaking a number of activities before the cover is placed. However, the intermediary may also undertake activities on behalf of the client during the period of cover.

25. An agreement which requires that the intermediary must give an ongoing supply to the insured over the period of insurance is not common. An agreement of this type usually only occurs when a broker has been appointed as the manager of the insured's insurance requirements (e.g., a risk manager role).

26. Further, a broker and insurer may enter into a commission agreement where the broker develops a product specifically for an industry or interest group. The broker may control the product and offer marketing, result monitoring and product development.

27. For example, a broker may have formulated a specialised facility for heavy haulage in conjunction with a particular underwriter. The broker's activities would include the development of the policy wording, marketing the product, selling and arranging the covers, monitoring the results and adjusting the covers to reflect the monitoring. In such a case, there may be an agreement in place to cover the ongoing service.

28. If the fee or commission charged by the intermediary is not refundable, it is a payment for a one-off supply. We do not consider it to be a payment for a supply that was made under an agreement that either expressly or impliedly provides for the supply to be made for a period or progressively over a period. This is the case unless the agreement between the intermediary and the client indicates otherwise.

29. In summary, without an agreement to the contrary, sections 6, 7 and 12 of the Transition Act do not operate to make any fee or commission paid to the intermediary before 1 July 2000, subject to GST, if no part (or whole) of the fee and commission is refundable.

Partial or pro-rata refundable amount

30. A partial or pro-rata refundable approach applies where a policy is cancelled and the broker provides a pro rata refund of the commission. A pro-rata refund could indicate that the intermediary is delivering a service to the insured and underwriter for the period of the policy or progressively over the period of the policy. In this case, the intermediary does not supply that part of the service relating to the period for which the policy is cancelled and the consideration relating to that part of the supply is refunded.

31. Often, the commission is a percentage of the premium. If some of the premium is refunded then some of the original commission may be refunded to maintain the same percentage of the premium actually paid as a commission to the intermediary. Consequently, as the premium is reduced, so too is the intermediary's commission.

32. Whether a refund of a premium indicates a supply is made progressively or for a period, or alternatively is a one-off supply, depends on the extent of the services that the intermediary has already supplied and the remaining services that are required or reasonably expected to be supplied under the agreement In the absence of an agreement, any commission retained is consideration for a one off supply.

Example

33. A broker arranges a policy of insurance with a premium of $12,000. The broker receives a commission of $1,800 (15% of the premium). The broker has not provided any further services in relation to the policy. After nine months of the policy, the broker's client cancels the policy and receives a refund of $1,000. This means the actual cost of the policy to the broker's client is $11,000 ($12,000 - $1,000). The commission on this policy should have been $1,650 (15% of $11,000). The broker refunds $150 ($1,800 - $1,650) to the insurer. In this case, the commission of $1,650 would be consideration for a one-off supply rather than a progressive supply or a supply made for a period.

34. In the above example, if the broker does additional servicing on behalf of the insurer during the period of insurance cover then the commission would be consideration for a progressive supply or a supply made for a period.[5]

Combination of both refundable and non-refundable amounts

35. Under a policy where the intermediary's fees are not refunded (but part of the commission is refunded), the discussion above in relation to the non-refundable approach would apply to the **fees**. However, the discussion above in relation to the refundable approach applies to the **commission**.

36. Also, where a policy is cancelled and the intermediary's fees are refunded (but part of the commission is not refunded), the

[5] Where a refund has occurred, Division 19 (Adjustment events) and Subdivision 29-A (The attribution rules) of *A New Tax System (Goods and Services Tax) Act 1999* need to be considered. Adjustment events and attribution rule guidelines will be the subject of future GST rulings.

discussion above in relation to the refundable approach applies to the **fees** and the discussion above in relation to the non-refundable approach applies to the **commission**.

Your comments

37. If you wish to comment on this draft Ruling, please send your comments promptly by **18 February 2000** to:

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Detailed contents list

38. Below is a detailed contents list for this Draft Ruling:

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Commissioner of Taxation
22 December 1999

Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

Subject references:

- progressive or periodic supplies
- time of supply or acquisition

Legislative references:

- ANTS(GSTT)A99 6
- ANTS(GSTT)A99 7
- ANTS(GSTT)A99 12
- ANTS(GSTT)A99 12(1)
- IABA84 9

Case references:

ATO references:
NO 99/17936-8
BO
ISSN: 1034-9758