



TA 2009/15 - Payment of inflated insurance premiums to a related party

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Taxpayer Alert

TA 2009/15

FOI status: may be released

Taxpayer Alerts are intended to be an "early warning" of significant new and emerging higher risk tax planning issues or arrangements that the Australian Taxation Office has under risk assessment, or where there are recurrences of arrangements that have been previously risk assessed.

Taxpayer Alerts will provide information that is in the interests of an open tax administration to taxpayers. Taxpayer Alerts are written principally for taxpayers and their advisers and they also serve to inform tax officers of new and emerging higher risk tax planning issues. Not all potential tax planning issues that the Tax Office has under risk assessment will be the subject of a Taxpayer Alert, and some arrangements that are the subject of a Taxpayer Alert may on further examination be found not to be of concern to the Tax Office. In these latter cases the Taxpayer Alert will be withdrawn and a notification published which will be referenced to that Taxpayer Alert.

Taxpayer Alerts will give the title of the issue (which may be a scheme, arrangement or particular transaction), briefly describe the issue and will highlight the features which are of concern to the Tax Office. These issues will generally require more detailed analysis to provide the Tax Office view to taxpayers.

Taxpayers who have entered into or are contemplating entering into an arrangement similar to that described in this Taxpayer Alert can seek a formal determination of the Tax Office's position through a private ruling (noting that the Taxation Administration Act 1953 sets out circumstances where the Commissioner may decline to issue such a ruling). Such taxpayers might also contact the tax officer named in the Taxpayer Alert and/or obtain their own advice.

This Taxpayer Alert is issued under the authority of the Commissioner.

Title Payment of inflated insurance premiums to a related party

This Taxpayer Alert describes an arrangement involving payments of amounts described as insurance premiums which are excessive by reference to the coverage provided and feature no significant transfer of insurance risk.

Description

This Taxpayer Alert applies to arrangements with features substantially equivalent to the following:

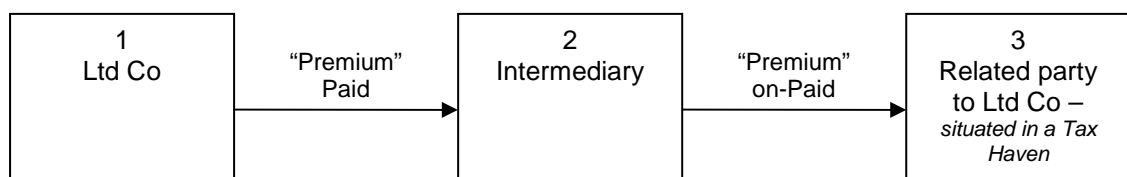
1. An entity (the paying entity) pays amounts described as insurance premiums to another party (the recipient).

2. The recipient may either pay on amounts to an entity controlled by the paying entity, or effectively hold the funds on the paying entity's behalf.
3. The paying entity and the recipient may be associates or otherwise related entities.
4. Alternatively, an intermediary may be used and the payment channelled through the intermediary to a related party or associate.
5. The recipient and any associated entity are situated overseas, frequently in a tax haven.
6. The paying entity claims a deduction for the inflated insurance premium.
7. Although allegedly for insurance,
 - (a) the amounts paid may be excessive in comparison to any insurance coverage provided, considering the conditions for future purported insurance recoveries, and/or
 - (b) there is no significant transfer of insurance risk.
8. In some cases, the dominant purpose of the arrangement may be to attempt to convert what is in substance an investment of funds into the form of a tax-deductible insurance premium.

Some arrangements may also combine the above features with characteristics substantially equivalent to those described in Taxpayer Alert TA 2009/9, "*Contrived cross-border arrangements that seek to generate debt deductions for non-assessable non-exempt income*".

For a discussion of the Tax Office approach to evaluating whether there has been a transfer of insurance risk please refer to *Law Administration Practice Statement PS LA 2007/8*.

Diagram of typical arrangement



Features which concern us

The Tax Office considers that an arrangement which exhibits the features outlined above may give rise to taxation issues that include whether:

1. such an arrangement or certain steps in it may be a sham;
2. the paying entity is entitled to a deduction under section 8-1 *Income Tax Assessment Act 1997* (ITAA 1997) in relation to what is described as an insurance premium, and the timing of any such deduction;

3. the amounts received by non-resident parties to the arrangement are properly Australian-sourced income for the purposes of subsection 6-5(3) of the ITAA 1997, and the timing of the inclusion of any amounts in assessable income;
4. payments under the arrangement are affected by the transfer pricing provisions of Division 13 of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936);
5. payments under the arrangement are dealt with by a Double Tax Agreement;
6. entities related to the paying entity making the payments are non-resident entities of Australia for taxation purposes, and if so whether they may be Controlled Foreign Companies under Part X of the ITAA 1936;
7. any resident taxpayers who are parties to the arrangement may be attributable taxpayers under Part X of the ITAA 1936 in respect of that entity's income, including tainted services income (under section 448 of ITAA 1936);
8. the general anti-avoidance rules contained in Part IVA ITAA 1936 may operate to cancel a tax benefit under the arrangement; and
9. any entity involved in the arrangement may be a promoter of a tax exploitation scheme for the purposes of Division 290 of Schedule 1 to the *Taxation Administration Act 1953*.

The Tax Office approach to evaluating these types of insurance arrangements is set out in Practice Statement PS LA 2007/8.

Note 1: *Administrative penalties of up to 50% of the scheme shortfall amount can apply where Part IVA is applied. Base penalties of up to 75% of the tax avoided can apply where you make a false and misleading statement to the Commissioner. Reductions in base penalty will be available if the taxpayer makes a voluntary disclosure to the Tax Office. If you have any information about the current arrangement, phone us on 1800 177 006. Tax agents wanting to provide information about people or companies who may be promoting arrangements covered by this alert should call the Tax Practitioner Integrity Service on 1800 639 745.*

Note 2: *Civil Penalties of up to 5,000 penalty units for individuals, 25,000 penalty units for bodies corporate or up to twice the amount of consideration received or receivable may be imposed by the Federal Court of Australia to promoters of tax exploitation schemes under Division 290 of Schedule 1 to the Taxation Administration Act 1953. The Commissioner can also apply to the Federal Court of Australia for restraining and performance injunctions against promoters where prohibited conduct has occurred, is occurring or is proposed.*

subject references:

Arrangement
Captive Insurance
Insurance Premium
Tax Haven

legislative references:

Income Tax Assessment Act 1936
Section 448
Division 13
Part IVA
Part X

Income Tax Assessment Act 1997
Section 6-5
Section 8-1

Taxation Administration Act 1953
Division 290 of Schedule 1

related practice statements:

Law Administration Practice Statement PS LA 2007/8

Date issued:	4 June 2009
Authorised by:	Stephanie Martin
	Deputy Commissioner
Contact Officer:	Bruce Collins
Business Line:	Aggressive Tax Planning
Section:	Technical and Case Leadership
Phone:	(02) 6216 2710
