


***TD 2004/78A1 - Addendum - Income tax:
consolidation: do subsections 705-75(1) and
705-80(1) of the Income Tax Assessment Act 1997
apply to any part of an accounting liability for
outstanding claims for the purposes of working out
step 2 of the allocable cost amount for a joining
entity that is a general insurance company?***

 This cover sheet is provided for information only. It does not form part of *TD 2004/78A1 - Addendum - Income tax: consolidation: do subsections 705-75(1) and 705-80(1) of the Income Tax Assessment Act 1997 apply to any part of an accounting liability for outstanding claims for the purposes of working out step 2 of the allocable cost amount for a joining entity that is a general insurance company?*

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Addendum

Taxation Determination

Income tax: consolidation: do subsections 705-75(1) and 705-80(1) of the *Income Tax Assessment Act 1997* apply to any part of an accounting liability for outstanding claims for the purposes of working out step 2 of the allocable cost amount for a joining entity that is a general insurance company?

This Addendum amends Taxation Determination TD 2004/78 to reflect changes introduced by Schedule 5 to the *Tax Laws Amendment (2010 Measures No. 1) Act 2010* and Schedule 5 to the *Tax Laws Amendment (Transfer of Provisions) Act 2010*. This Addendum also reflects changes to Accounting Standard AASB 1023.

TD 2004/78 is amended as follows:

1. Paragraph 1

After (ITAA 1997); insert footnote:

¹ All legislative references are to the ITAA 1997 unless otherwise indicated.

2. Paragraphs 2 to 4

Omit the paragraphs; substitute:

2. The step 2 amount of the ACA is worked out under subsection 705-70(1) by:

... adding up the amounts of each thing (an **accounting liability**) that, in accordance with the joining entity's *accounting principles for tax cost setting, is a liability of the joining entity at the joining time.

3. An entity carrying on general insurance business activities, including general reinsurance, must report its liability in respect of its outstanding claims in accordance with paragraph 5.1 of Australian Accounting Standards Board 1023 (AASB 1023) 'General Insurance Contracts'. Paragraph 5.1 reads:

An outstanding claims liability shall be recognised in respect of direct business and reinsurance business and shall be measured as a central estimate of the present value of the expected future payments for claims incurred with an additional risk margin to allow for the inherent uncertainty in the central estimate.

4. As a liability for outstanding claims is recognised in the entity's financial statements at the joining time, it must be included in working out step 2 of the ACA under subsection 705-70(1). Consideration must then be given to whether subsections 705-75(1) and 705-80(1) apply to any part of the liability for outstanding claims.

3. Paragraph 5 and heading

Omit all occurrences of 'of the ITAA 1997'.

4. Paragraphs 6 and 7

Omit the paragraph; substitute:

6. Consistent with AASB 1023, the accounting liability for outstanding claims is to be measured as the present value of expected future payments, which must include indirect claims handling costs. In accordance with paragraph 5.2.3:

Indirect handling costs incurred during the reporting period are also expenses of an insurer, and include a portion of the indirect claims handling costs to be paid in the future, being that portion which relates to handling claims incurred during the reporting period. The outstanding claims liability includes these unpaid indirect claims handling costs.

7. For income tax purposes, the liability for outstanding claims is adjusted in accordance with section 321-20. The value arrived at under that section is the 'outstanding claims liability' (OCL). The value of OCL is worked out as follows:

Step 1

Add up the amounts that, at the end of an income year, the company determines, based on proper and reasonable estimates, to be appropriate to set aside and invest in order to meet:

- (a) liabilities for outstanding claims under those policies; and
- (b) direct settlement costs associated with those outstanding claims.

Step 2

Reduce the step 1 amount by so much of it as the company expects at the end of the income year to recover:

- (a) under a contract of insurance; or
- (b) in any other way.

other than under a contract of reinsurance to which subsection 148(1) of the *Income Tax Assessment Act 1936* (about reinsurance with non-residents) applies.

5. Paragraph 8

Insert at the end of the first sentence '(synonymous with the term 'indirect claims handling costs')'.

6. Paragraphs 9, 13 and 15 to 17

Omit all occurrences of 'of the ITAA 1997'.

7. Paragraphs 10 and 11

Omit all occurrences of 'of Schedule 2J of the ITAA 1936'.

8. Paragraph 14 and heading

(a) Omit both occurrences of 'of the ITAA 1997'.

(b) Omit 'accounting standards or statements of accounting concepts'; substitute 'the joining entity's *accounting principles for tax cost setting'.

9. Subject references

Insert:

- joining entity's accounting principles for tax cost setting

10. Legislative references

(a) Omit:

- ITAA 1936 Sch 2J Div 321
- ITAA 1936 Sch 2J 321-10
- ITAA 1936 Sch 2J 321-15
- ITAA 1936 Sch 2J 321-20

(b) Insert:

- ITAA 1997
- ITAA 1997 Div 321
- ITAA 1997 321-10
- ITAA 1997 321-15
- ITAA 1997 321-20

11. Other references

Omit 'Australian Accounting Standards Board 1023 – Financial Reporting of General Insurance Activities (1996)'; substitute 'Australian Accounting Standards Board 1023 – General Insurance Contracts '.

This Addendum applies before and after its date of issue.

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Commissioner of Taxation

23 March 2011

ATO references

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