GST AND GENERAL INSURANCE

History now records that the GST came into effect in Australia on 1 July 2000.

The main piece of legislation implementing the GST is the A New Tax System (Goods and Services Tax) Act 1999 (**'GST Act'**). The A New Tax System (Goods and Services Tax) Transition Act 1999 (**'GST Transition Act'**) contains the transitional rules that apply to certain supplies or acquisitions of goods or services after 1 July 2000, and provisions to accommodate the transition from the former wholesales sales tax system.

In this paper all references to section numbers are references to sections of the GST Act, except where otherwise indicated.

The general scheme of the GST Act is that supplies by GST-registered businesses attract GST, unless those supplies are GST-free, input taxed or a special exception applies (for example under the GST Transition Act). Acquisitions of goods or services that are to be used by a GST-registered business to make GST-taxable or GST-free supplies give rise to an input tax credit or, in some instances, a GST adjustment which reduces the GST payable by the insurer.

One of the areas of the new tax system where there is still substantial uncertainty is the question whether GST-registered businesses are liable for GST when they receive compensation payments, such as insurance payouts, commercial settlements and Court awarded damages. While indications are that the ATO considers that such compensation payments attract GST, there is support from one of the first Court decisions on the GST where it was held that they do not.

In contrast, the GST treatments of different types of insurance policies are relatively clear. Division 78 of the GST Act contains the special rules that apply to calculating the GST payable on an insurance policy, and in respect of settlements made by an insurance company.

Which kinds of insurances attract GST?

General Insurance - taxable

The supply of most types of general insurance attracts GST. An **'insurance policy'** is defined in section 195-1 of the GST Act as:

> '... a policy of insurance (or of reinsurance) against loss, damage, injury or risk of any kind, whether under a contract or a law. However, it does not include such a policy to the extent that it does not relate to insurance (or reinsurance) against loss, damage, injury or risk of any kind.'

This means that the GST applies not only to commercial insurance contracts, but also to statutory insurance schemes such as workcover and third party motor vehicle insurances.

Life insurance – input taxed

Life insurance is an input taxed financial supply. This means that the insurer is not liable for GST on life insurance premiums, and the insurer is generally ineligible to claim input tax credits for GST paid on goods and services used in connection with its life insurance business.

Health insurance – GST-free

Private health insurance, as defined under the National Health Act 1953 is GST-free. Ambulance service levies and insurance are also GST-free.

GST and general insurance premiums

General insurance premiums attract GST. The insurer is liable for GST on the premium, and as a matter of contract will add the cost of the GST to the amount of the premium. The amount of State or Territory stamp duty payable on the premium is disregarded, so that GST does not apply to stamp duties on insurance policies.[1]

A GST-registered business can claim an input tax credit for the GST paid on an insurance policy (except to the extent that it makes an input taxed supply). However under the GST Transition Act, as a transitional measure no input tax credit can be claimed in respect of compulsory third party motor vehicle insurance policies until 1 July 2003.

No input tax credit can be claimed where the insurance is acquired for private or domestic purposes – for example home and contents insurance or private motor

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vehicle insurance.

What happens when an insurance company pays an insurance settlement?

Division 78 of the GST Act contains the special rules that apply to insurance companies when they make an insurance settlement.

Insured/claimant not liable for GST on the insurance settlement

The party receiving the settlement from the insurer is not liable for GST on the settlement proceeds irrespective of whether the settlement is business related or private. Section 78-45 provides that the payment of money, and/or the making of a supply by an insurer in settlement of a claim, is not consideration for a supply by the entity insured or any other entity that was entitled to an input tax credit on the premium for the policy.

However, the insured/claimant is eligible to claim input tax credits for goods or services purchased from the settlement of a claim that are to be used to make GST-taxable or GST-free supplies. The ordinary input tax credit rules operate, unaffected by Division 78.

Insurer not entitled to an input tax credit for insurance settlement

Section 78-20 provides that the payment of money, and/or the making of a supply, by an insurer in settlement of a claim is not treated as consideration for an acquisition by the insurer. This means that the insurer cannot claim an input tax credit in respect of the settlement amount. The insurer is not entitled to an input tax credit for the creditable acquisition that arises otherwise under section 11-5 for the payment and/or the supply.

GST and general insurance
continued from page 22

Section 78-25 provides that a supply that an insurer makes in settlement of a claim is not treated as a taxable supply. This means that the insurer is not liable for GST on the amount of the claim that is released or discharged by the claimant.

If the policy holder was not entitled to an input-tax credit for the policy premium, the insurer is entitled to a GST adjustment (a decreasing adjustment) under section 78-10 that has the same impact as if the insurer could have claimed an input tax credit on the settlement amount.

Decreasing adjustment on settlements

Division 78 also provides for a decreasing adjustment for insurers in respect of such payments or supplies made in settlement of a claim. Certain conditions that are stated in section 78-10 have to be met for a decreasing adjustment to be available. The insurance company needs to know, before the policy holder makes a claim, whether the policy holder is entitled to claim an input tax credit on the insurance premium.

If there is no entitlement to claim a full input tax credit for premiums paid on the insurance policy, the insurer is entitled to a decreasing adjustment of 1/11th of the settlement amount under subsection 78-15(1). On the other hand, if there is entitlement to a full input tax credit for premiums paid, the insurer is not entitled to a decreasing adjustment under subsection 78-10.

1 GST Act, section 78-5.

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** inclusive of GST*

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