



Accounting for withholding tax on foreign resident reinsurers under AASB 17¹

AASB 17 TRG – December 2022

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Background

1. The AASB 17 TRG has previously discussed an Insurance Council of Australia Working Group paper on government imposts at its December 2021 and September 2022 meetings.
2. Those discussion were directed at identifying government imposts associated with insurance contracts that fall within one or other of the following categories:
 - A. an amount collected by the insurer on behalf of a 3rd party, which is not treated as an expense or revenue of the insurer;
 - B. a cost of issuing insurance contracts, whereby any amount collected to defray the cost of the impost is treated as revenue and the amount paid to the government is treated as an expense of the insurer;
 - C. reinsurance premiums ceded.²
3. There has been a lack of consensus about the categorisation of withholding tax on foreign resident reinsurers.

Australia

4. For reinsurance premiums paid to a foreign resident reinsurer to be deductible and the recoveries assessable for the ceding Australian insurer, the ceding Australian insurer would make an election under section 148 of the *Income Tax Assessment Act 1936*. In this case, the ceding insurer would be assessed and liable to pay tax as agent, on an amount equal to 10% of the sum of the gross amounts of the premiums paid or credited in the year of income. [Appendix A quotes section 148.]
5. Technically, the tax is an income tax (rather than a withholding tax) on the 10% profit assumed by the ATO to be made by the reinsurer.³
6. Assuming a company tax rate of (say) 30%, that tax payable is 3% of premiums. The insurer needs to forward the withholding tax to the ATO using a tax return specific to that purpose and using a TFN obtained for that purpose.

1 This paper refers to AASB 17 *Insurance Contracts*, which has the same content as NZ IFRS 17 *Insurance Contracts*.

2 While reinsurance is not an 'impost', it is included here because governments are involved in providing reinsurance for particular types of business, sometimes on a compulsory basis.

3 This paper does not address the accounting by the reinsurer, which would need to determine whether to account on a gross basis (and recognise revenue for 100% of the premium it notionally receives and tax withheld under IAS 12 *Income Taxes*) or on a net basis (and recognise revenue for the 97% of the premium it actually receives and ignore the tax impacts).

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7. Typically, the following also applies:
- amounts are settled on a net basis such that the withholding tax amount is deducted from ceded premiums which are also net of claim recoveries);
 - the withholding tax amount is posted to a tax holding account for remittance to the ATO and is paid on assessment when the return is due to the ATO; and
 - reinsurance contracts generally include generic clauses which note that payments are subject to applicable taxes in the region.

New Zealand

8. When an insured party in New Zealand pays a premium (including a reinsurance premium) to an overseas insurer, and that insurer does not have a branch in New Zealand, the insured party is considered to be the insurer's agent. They are required to file an annual income tax return as agent for the foreign insurer – unless the foreign insurer or person acting on their behalf has already filed a return.
9. Ten percent of the premium is treated as taxable income, which is then taxed at the corporate tax rate (28%). The responsibility for filing the income tax return, and paying the income tax, lies with the party paying the premium.

Alternative views

10. The typical Australian circumstances are used for discussion purposes below.
11. **View 1** is that the insurer is simply acting as a collector of income tax (or a substitute for income tax) for the government because the amount collected relates to particular transactions and is the amount 'paid' to government (albeit together with other taxes).
12. **View 2** is that, in effect, of the total reinsurance premium payable by the ceding insurer, 97% is paid to the reinsurer and 3% to the ATO. There is no additional cost to the ceding insurer, merely a direction to allocate reinsurance premiums in a particular manner. Hence, 100% of the premium ceded comprises an expense of the ceding insurer, with 3% of the total reinsurance premium paid to the ATO and the remaining 97% to the reinsurer.
13. The factors in the following table were identified in the Insurance Council of Australia Working Group paper for determining whether government imposts are collections on behalf of a 3rd party [View 1] or revenue/expenses of the insurer [View 2].

Computed at a transactional or entity level?	At a reinsurance contract held level which may support View 1 But there may be multiple contracts with the same or different foreign reinsurers, which may support View 2
Based on a fixed percentage?	The percentage is specified, which may support View 1 But it can be viewed as a shortcut to identifying tax on profit which may support View 2 OR It can be viewed as an amount paid on behalf of the reinsurer and akin to the <i>withholding tax on income replacement payments</i> , which the TRG agreed is an expense of the insurer [View 2]
Remitted on a periodic basis to Government?	Yes, but with other taxes annually (and those other taxes are expenses/revenues of the insurer), which may support View 2

Outreach on current practices and whether practice might need to change

14. Informal outreach conducted among Australian insurers in September and October indicated that most insurers currently apply View 2 in the context of AASB 4, AASB 1023 and AASB 1038.
15. Accordingly, it is reasonable to consider whether there is anything 'new' in AASB 17 that would cause an insurer to change its current accounting policy.
16. AASB 17.B121, which addresses revenue from insurance contracts issued says (emphasis added):
 - B121 Paragraph 83 requires the amount of insurance revenue recognised in a period to depict the transfer of promised services at an amount that reflects the consideration to which the entity expects to be entitled in exchange for those services. The total consideration for a group of contracts covers the following amounts:
 - (a) amounts related to the provision of services, comprising: ...
 - (ia) **amounts related to income tax that are specifically chargeable to the policyholder;**
17. Considering the application of AASB 17.B121 from a reinsurance contract held perspective, the withholding tax might be viewed as an amount paid by the ceding insurer that is specifically chargeable to the reinsurer. It might be argued that, by analogy with taxes paid on behalf of policyholders being part of an insurer's revenue, the withholding tax is part of the ceding insurer's expenses.
18. The requirements more generally around accounting for taxes related to transactions, including insurance and reinsurance contracts, have not changed. There were no amendments to AASB 112 *Income Taxes* or AASB Interpretation 1031 *Accounting for the Goods and Services Tax (GST)* when AASB 17 was issued.
19. Consistent with AASB Interpretation 1031, AASB 17.B124 says insurance revenue does not include amounts that relate to transaction-based taxes collected on behalf of third parties (such as premium taxes, value added taxes and goods and services taxes). [Appendix B sets out AASB 17.B124 in full.]

Appendix A

Section 148 of the *Income Tax Assessment Act 1936* notes the following in relation to reinsurance with non-residents (emphasis added):

- (1) Notwithstanding anything contained in this Act other than section 177F, but subject to this section, where a person carrying on the business of insurance in Australia reinsures out of Australia the whole or part of any risk with a non-resident:
 - (a) the premiums paid or credited in respect of the reinsurance shall not be:
 - (i) an allowable deduction to the person carrying on the business of insurance in Australia; or
 - (ii) included in the assessable income of the non-resident; and
 - (b) the income of the person carrying on the business of insurance in Australia shall not include sums recovered from that non-resident in respect of a loss on any risk so reinsured.
- (2) A person carrying on the business of insurance in Australia who reinsures out of Australia the whole or part of any risk with a non-resident may elect, in accordance with this section, that the provisions of subsection (1) shall not be applied in arriving at that person's taxable income, and thereupon:
 - (a) those provisions shall not apply in arriving at that person's taxable income of a year of income to which the election applies; and
 - (b) **that person shall be liable to furnish returns, and to pay tax**, in accordance with the succeeding provisions of this section, **as agent for all non-residents with whom that person so reinsures**.
- (3) Where a person makes an election under subsection (2), he or she shall, subject to subsection (5), **be assessed and liable to pay tax as agent, on an amount equal to 10% of the sum of the gross amounts of the premiums paid or credited by him or her in the year of income** (being a year of income to which the election applies) to non-residents in respect of all such reinsurances, as if that amount were the taxable income of a non-resident company (not being a private company) not carrying on business in Australia by means either of a principal office or a branch. ...'

Appendix B

Extracts from AASB 17:

B121 Paragraph 83 requires the amount of insurance revenue recognised in a period to depict the transfer of promised services at an amount that reflects the consideration to which the entity expects to be entitled in exchange for those services. The total consideration for a group of contracts covers the following amounts:

- (a) amounts related to the provision of services, comprising:
 - (i) insurance service expenses, excluding any amounts relating to the risk adjustment for non-financial risk included in (ii) and any amounts allocated to the loss component of the liability for remaining coverage;
 - (ia) amounts related to income tax that are specifically chargeable to the policyholder;
 - (ii) the risk adjustment for non-financial risk, excluding any amounts allocated to the loss component of the liability for remaining coverage; and
 - (iii) the contractual service margin.
- (b) amounts related to insurance acquisition cash flows

B124 Consequently, insurance revenue for the period can also be analysed as the total of the changes in the liability for remaining coverage in the period that relates to services for which the entity expects to receive consideration. Those changes are:

- (a) insurance service expenses incurred in the period (measured at the amounts expected at the beginning of the period), excluding:
 - (i) amounts allocated to the loss component of the liability for remaining coverage applying paragraph 51(a);
 - (ii) repayments of investment components;
 - (iii) amounts that relate to transaction-based taxes collected on behalf of third parties (such as premium taxes, value added taxes and goods and services taxes) (see paragraph B65(i));
 - (iv) insurance acquisition expenses (see paragraph B125); and
 - (vi) the amount related to the risk adjustment for non-financial risk (see (b)).