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3 March 2016

Dear Dr Dermody

### **Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016**

Lloyd's is extremely grateful for the Committee's willingness to receive submissions as part of its inquiry into the provisions of the Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016 ("the Bill").

We welcome the intention of the proposed measures in Schedules 1 & 2 to the Bill, in particular to limit unnecessary obligations and compliance costs on foreign (i.e. non-Australian resident) suppliers of intangibles to Australian businesses.

We respectfully submit however that, in the context of non-resident insurance supplies and particularly when applied to the unique Lloyd's business structure, some of the measures will treat fundamentally identical insurance supplies in different ways from a GST perspective. Lloyd's submits this

1. will increase complexity for resident insurance agents and brokers increasing the costs associated with compliance;
2. will increase the likelihood of GST errors and therefore the need for the Australian Taxation Office to direct resources to this area;
3. will increase costs for Lloyd's (in settling claims); and
4. could distort the market and affect Lloyd's competitiveness in it.

We believe that there may be a straightforward solution to this that would not undermine the intent or effect of the Bill.

The Bill as drafted proposes to 'turn off' the current GST rules in relation to taxable supplies made by a non-resident supplier through a resident agent<sup>1</sup> to Australian businesses. We

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<sup>1</sup> Proposed amendments to s57-5 and the new s9-26

would propose an amendment to maintain the current GST treatment where a non-resident insurer and a resident agent of the non-resident insurer agree in writing that the supplies should remain within the scope of Australian GST.

In the attachments we have sought to provide you with additional background to illustrate the scale of insurance written in Australia by Lloyd's and the degree of the problem that this Bill will create if passed in its current form. We have also taken the opportunity to highlight the important role Lloyd's fulfils in supporting Australian business, big and small. In addition in Appendices 2 and 3 we have set out diagrammatically the issue, to assist the Committee's understanding, and our suggested legislative amendments in Appendix 4.

We are hopeful that the Committee will take our submission into account in the course of making its recommendations to the Senate.

For completeness, I should add that Lloyd's has made similar representations to the Australian Taxation Office ("ATO") and to the Australian Treasury shortly after the introduction of the Bill into the House of Representatives on 10 February 2016. It was only at this time that Lloyd's recognised the significant impact upon its business through the proposed changes in the Bill.

Similar representations have also been made to New Zealand's Finance and Expenditure Select Committee. We are hopeful of a similar amendment to their draft Taxation (GST on Online Services Bill) which has similar aims to your Bill and is before their Parliament at the moment.

Please do let me or Brad Miller<sup>2</sup>, Indirect Tax Partner at EY, know if you would like further information.

Yours faithfully

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## Appendix 1

### Introduction

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Lloyd's is an insurance market, not an insurance company. The Lloyd's market enables individuals, limited partnerships and corporations, known as Lloyd's Members, to join together into syndicates to insure risks.

Lloyd's has a network of over 120 agents ("coverholders") in Australia that have the authority to conclude a contract of insurance ("binding authority") with an Australian insured. There will often also be an Australian broker involved representing the insured's interests. In 2014 just under half the total business was written in this way.

Business is also brought to the market in London by an authorised intermediary acting on behalf of an Australian insured and concluded face-to-face in the Lloyd's building ("direct business").

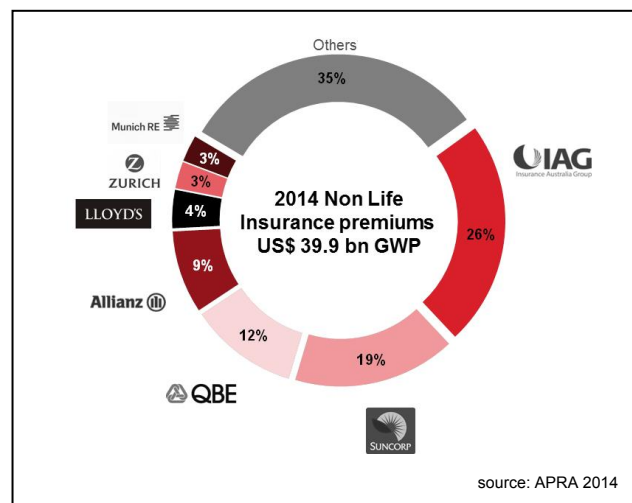
B2B insurance may be written on a co-insurance basis where several insurance carriers will accept a portion of a single risk. Some, but not all, of those carriers may be Australian residents.

### Lloyd's in Australia

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Australia is an important market for Lloyd's. It is our third largest after North America and the UK. We wrote our first policy in Australia over 150 years ago and today accept approximately A\$2bn of insurance premium from individuals and business each year, around 4% of the total Australian non-life market.

Much of our business is in specialist classes mainly to businesses ("B2B" insurance) – professional liability, property catastrophe, accident and health, marine, cyber threat, terrorism, real estate etc – supporting Australian business (big and small), by taking billions of dollars of risk off their balance sheets.



Below are some of the key facts about Lloyd's in the Australian market:

- Fifth largest non-life insurer in Australia
- Insurance cover provided to two thirds of ASX top 100 companies
- Member of the Insurance Council of Australia, Strategic Partner of the Underwriting Agencies Council, signatory to the General Insurance Code of Practice

- A\$2.4bn security held in Australian trust funds
- A\$2bn of premium annually,
  - approximately  $\frac{3}{4}$  insurance,  $\frac{1}{4}$  reinsurance
  - just under half written under binding authority in Australia
  - approximately 40% of business is casualty, 35% property, 12% accident and health, 6% marine, 3% energy
- 120 resident coverholders with over 190 offices across Australia
- Of the hundreds of thousands of insurance policies written annually by coverholders each year, at least one-third of we believe will be B2B
- Tens of thousands of insurance claims administered annually in Australia by the coverholders (and third parties, e.g. loss adjusters, lawyers etc)
- Claims payments of A\$147m following the Victorian bushfires in February 2009 and A\$426m following the flooding in Queensland in 2010 and 2011<sup>3</sup>

More information and background to Lloyd's can be found at our website, [www.lloyds.com/](http://www.lloyds.com/).

## GST and B2B insurance in Australia

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As described above, B2B business may be written by a resident coverholder (an agent of the insurer) or in London usually through an independent resident broker (an agent of the insured).

### **B2B business written through an independent broker**

The insurance contract is executed outside Australia. Under both the current and intended future law, no GST is chargeable on the premium and there is no right to recovery of GST included in any Australian costs incurred by the non-resident insurer (e.g. legal costs related to settlement of claims, etc).

Lloyd's is not asking for any changes to these rules.

### **B2B business written through a resident coverholder**

In addition to the explanation below, in Appendix 2 we have illustrated and analysed how the current GST provisions and the proposed GST provisions will apply to insurance written in Australia by Lloyd's coverholders. In Appendix 3 we provide guidance on the implications

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<sup>3</sup> Ranked as the most respected insurer for large corporates by the Aon Australia Risk Survey following the Queensland floods

for claims settlements under both the current GST provisions and proposed GST provisions. Both these appendices provide further detail as to the underlying transactions and associated GST implications.

### *Current law*

The insurance contract is executed in Australia. Under current law the Australian resident coverholder is required to charge and remit GST on the premium on behalf of the Lloyd's member. The GST included in certain Australian costs in relation to claims may be reclaimed by coverholders, again on behalf of the Lloyd's members.

### *Intended future law*

As it stands, the Bill will 'disconnect' an insurance supply made by a non-resident insurer to Australian businesses, even when bound in Australia by a resident agent. We highlight though that where that insurance is written by a coverholder to an Australian consumer ("B2C"), the coverholder will continue to have the obligation to collect and remit GST on those policies.

### **Impacts**

#### *1. GST "on" for B2C; but "off" for B2B*

While coverholders will be required to continue to charge GST on non-resident B2C insurance supplies, they will need to 'switch off' GST on non-resident B2B supplies. This in itself requires the coverholders to understand whether an insured is acquiring insurance in a personal or business capacity to determine the resultant GST treatment. This is not always as simple as it might seem, especially when the coverholder is dealing with another insurance intermediary, e.g. a resident broker, and not directly with the insured.

This will necessitate systems changes, possibly simply to reflect changed GST charges on policy quotations for example, which will increase compliance costs for resident coverholders. However, we have not been able to identify the cost for each coverholder that would attach to such changes. To do so would be difficult exercise in itself given the large number of coverholders, approximately 120, which currently collect and remit GST on behalf of the Lloyd's Members, and therefore are the taxpayers in relation to this matter. It would certainly require changes to process documentation and literature provided to brokers to assist with their administration of the GST. Again we are unable to estimate the cost for each coverholder of this.

#### *2. Co-insurance*

For B2B co-insurance arrangements involving both Australian and non-resident insurers, under the proposed Bill, resident coverholders and insurance brokers will in future have to apportion GST between non-resident and resident suppliers for premium and any claims costs, heightening the risk of GST errors.

While all of this may appear to be a straightforward matter for relatively sophisticated businesses, our experience shows that *any* additional administrative burden placed on brokers attaching to Lloyd's business vs. that attaching to a resident carrier is likely to act as

a disincentive to use Lloyd's. In simple terms, if a broker has an easier option, they will take it.

### *3. Incorrect GST claims by insureds*

The proposed changes may also lead to tax leakage to the Australian Revenue if insureds fail to appreciate the subtleties of a split supply and incorrectly claim in full GST equal to 1/11<sup>th</sup> of the policy premium, notwithstanding GST may have only applied to a portion of the policy premium, perhaps leading to the ATO needing to direct resources to address the issue, a point the ATO seemed to acknowledge during our meetings with them.

### *4. GST to remain on claims costs*

It has also been Lloyd's experience in other countries that where local suppliers are dealing with local coverholders they are reluctant to treat their services as GST-free on the basis they are dealing with a locally-resident entity, notwithstanding the coverholder is representing a non-resident. Thus Lloyd's envisages that while GST may be 'turned-off' on its supplies, it is likely that its suppliers within Australia will continue to include GST in their invoices, adding to Lloyd's costs in a way the law does not intend.

### *5. GST to remain on claims costs*

As can be seen from the above, it is clear that for the coverholders the compliance costs associated with the current GST legislation are low as they are able to automate the addition of GST to all premiums collected regardless of whether or not the insurer is an Australian resident and whether the insured is a business or end-consumer. These costs must increase if coverholders have to apply different rules to fundamentally identical insurance supplies.

### *6. Fair share of tax*

Finally, the Bill would have the effect of making Lloyd's supplies of insurance appear "GST free" which may be unwelcome for Lloyd's and the Australian Government at a time when there is sensitivity about the tax contribution made by large businesses, especially non-resident businesses.

We submit therefore that the Bill is likely to cause confusion in the market in which Lloyd's writes in excess of \$2 billion insurance each year through resident agents. There may be costs for Australian businesses attached to implementing and operating the change but we have been unable to estimate them. Since the Explanatory Note to the Bill explains that its aim is to reduce compliance costs, we would urge the Senate to make the minor change we are requesting. This will leave the treatment of non-resident insurance supplies through a resident agent unchanged (where the parties agree to that treatment), remove the confusion and complexity the change would create and the potential for it to undermine Lloyd's competitive position in the Australian market.

## Why is a law change needed now?

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The right time to fix the unintended consequences is in the current Bill before it becomes law. If the Bill is passed without amendment, but subsequently amended, coverholders could be in the undesirable position of having to change processes and procedures twice with risk for taxpayers and ATO in the transition; an undesirable outcome for both parties.

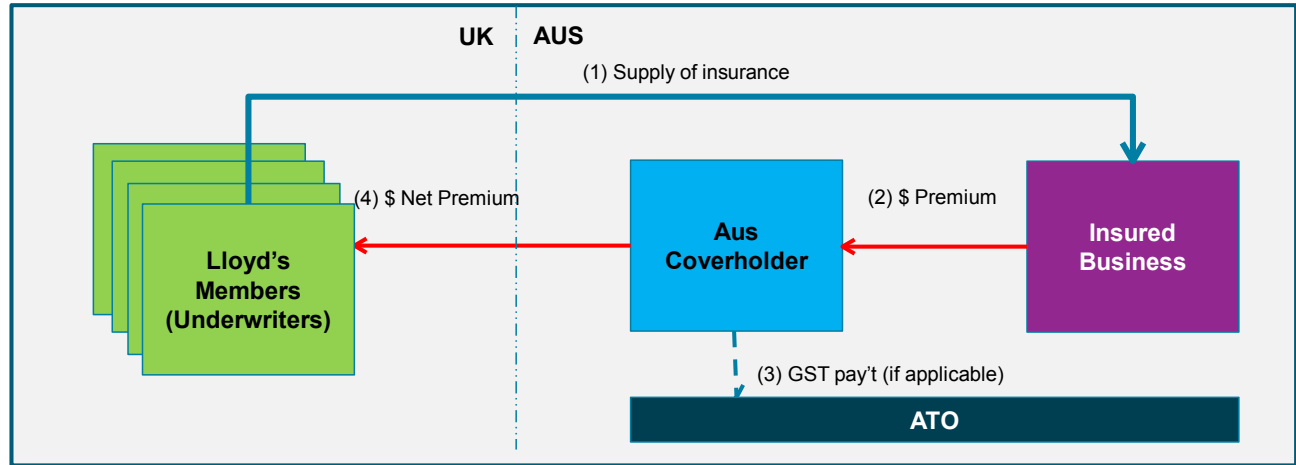
## What is the amendment that is required?

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In light of the above, we have included suggested legislative amendments to the Bill in Appendix 4 which will accommodate Lloyd's requirement for the B2B insurance supplied through resident coverholders remaining "connected" with Australia for GST purposes. This will result in the resident agent continuing to account for the GST liability on all Lloyd's policies written through it, regardless of whether they are B2B or B2C. In other words, it will maintain the status quo and avoid what we consider were unintended complexities and inequities as set out in our submission.

Our proposed amendments are to the existing section 57-5 and the proposed section 9-26. You will note we have included two alternatives with regard to section 57-5, the first new subsection (4) applying to all supplies, the second alternative new subsection (4) being narrower and only applying in the insurance context. We would be pleased to discuss any questions or comments you may have with regard to these suggested legislative amendments.

## Appendix 2: GST treatment of B2B insurance premium written by Lloyd’s coverholders in Australia

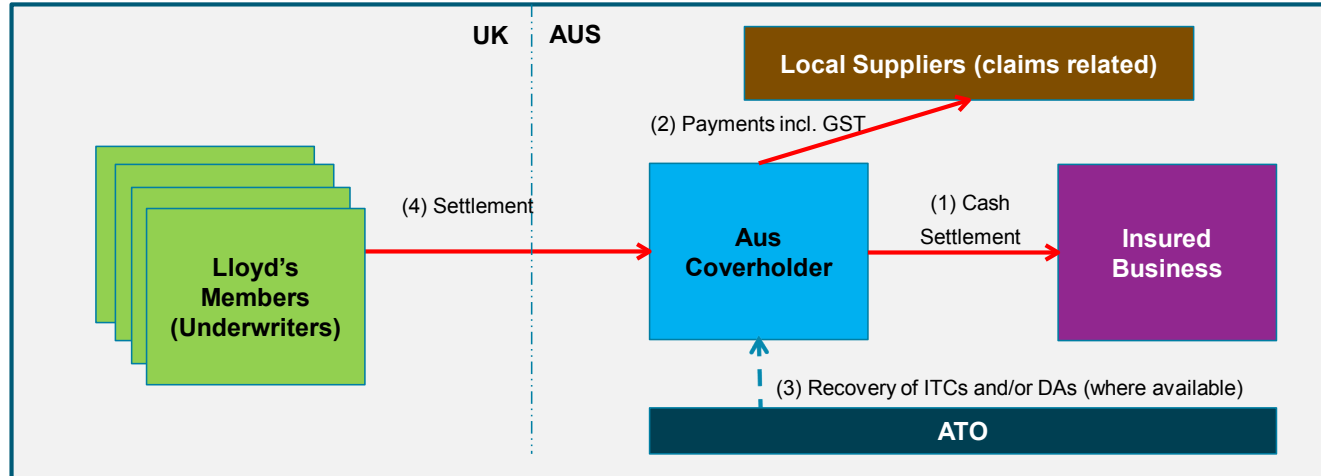


	Current treatment	Future treatment	Comment
(1) & (2)	Premium received by coverholder is subject to GST	Premium received by coverholder <u>not</u> subject to GST (supply “disconnected”),	<b>Complexity</b> - different tax outcomes depending on identity of insured (consumer or business) and of insurer (Lloyd’s or domestic, especially in co-insurance arrangements where premium may need to be split between taxable and non-taxable supplies)
(3)	GST remitted to ATO (and input tax credit claimed by insured)	No GST to ATO (no input tax recovery for insured)	<i>Should</i> be neutral for ATO but <b>risk</b> an Australian business will claim full input recovery even if only on part of the premium is subject to GST under co-insurance arrangements
(4)	Premium net of GST paid to Lloyd’s	No GST deduction from premium paid to Lloyd’s	Lloyd’s insurance will appear “GST free” – <b>optically unhelpful</b>

**Maintaining the current treatment would solve all these issues at no cost to ATO**



Appendix 3: GST treatment of B2B claims settlement costs for Lloyd’s coverholder business in Australia



	Current treatment	Future treatment	Comment
(1)	May be able to claim Decreasing Adjustment (“DA”)	No longer able to claim DA	<b>Unlevel playing field</b> for Lloyd’s vs domestic insurers, potential <b>confusion</b> on co-insurance arrangements with mix of domestic and Lloyd’s carriers
(2)	GST charged by local suppliers	GST still <i>likely</i> to be charged by local suppliers (as they deal with an Australian resident coverholder)	<b>Complexity and confusion</b> in the market as some suppliers try to manage dealing with mix of taxable and non-taxable business
(3) & (4)	Coverholders claim input tax credits and DAs (in limited circumstances): claims settlement from Lloyd’s is net of GST recoveries	Coverholders cannot claim input tax credits and DAs: claims settlement costs for Lloyd’s increase	Lloyd’s costs are greater than a domestic supplier creating an <b>unlevel playing field</b> and affecting competitiveness

**Maintaining the current treatment would solve these issues with no cost to ATO (vs the current position)**

## Appendix 4: Proposed recommended edits to the Bill

- Legislation shown in “black” below is existing legislation;
- Legislation shown in “blue” is proposed legislation in the *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*
- Marked up edits in “red” and “green” are suggested changes

### A NEW TAX SYSTEM (GOODS AND SERVICES TAX) ACT 1999

#### 57-5 Who is liable for GST

(1) GST payable on a \* taxable supply or \* taxable importation made by a \* non-resident through a \* resident agent:

- (a) is payable by the agent; and
- (b) is not payable by the non-resident.

(2) This section has effect despite sections 9-40 and [13-15](#) (which are about liability for GST).

[\(3\) However, this section does not apply to a \\*taxable supply if:](#)

- [\(a\) apart from this section, the \\*non-resident would not be liable to pay GST on the supply; or](#)
- [\(b\) the non-resident makes the supply through an \\*enterprise that the non-resident \\*carries on in the indirect tax zone.](#)

[\(4\) Despite subsection \(3\) this section continues to apply where:](#)

- [\(a\) the non-resident and resident agent agree in writing that this section apply; and](#)
- [\(b\) the written agreement specifies the types of supplies to which this section applies.](#)

Alternatively, a specific sub-section dealing with insurance only could read as follows:

[\(4\) Despite subsection \(3\) this section continues to apply where a non-resident insurer and the resident agent of the non-resident insurer agree in writing that this section apply to supplies of insurance by the non-resident insurer through the resident agent.](#)

## 9-26 Supplies by non-residents that are not connected with the indirect tax zone

- (1) A supply is *not connected with the indirect tax zone* if:
  - (a) the supplier is a \*non-resident; and
  - (b) the supplier does not make the supply through an \*enterprise that the supplier \*carries on in the indirect tax zone; and
  - (c) the supply is covered by an item in this table:

Offshore supplies that are not connected with the indirect tax zone		
Item	Topic	These supplies are <i>not</i> connected with the indirect tax zone ...
1	Inbound intangible supply	a supply of anything other than goods or *real property if: <ul style="list-style-type: none"> <li>a) (a) the thing is done in the indirect tax zone; and</li> <li>b) (b) the *recipient is an *Australian-based business recipient of the supply.</li> </ul>
2	Intangible supply between non-residents	a supply of anything other than goods or *real property if: <ul style="list-style-type: none"> <li>c) (a) the thing is done in the indirect tax zone; and</li> <li>d) (b) the *recipient is a *non-resident that acquires the thing supplied solely for the purpose of an *enterprise that the recipient *carries on outside the indirect tax zone.</li> </ul>
3	Supply between non-residents of leased goods	a supply by way of transfer of ownership of leased goods if: <ul style="list-style-type: none"> <li>e) (a) the *recipient is a *non-resident that does not acquire the thing supplied solely or partly for the purpose of an *enterprise that the recipient *carries on in the indirect tax zone; and</li> <li>f) (b) the lessee:                             <ul style="list-style-type: none"> <li>(c) (i) made a *taxable importation of the goods before the supply was made; and</li> <li>(d) (ii) continues to lease the goods on substantially similar terms and conditions after the supply is made.</li> </ul> </li> </ul>
4	Supply by way of continued lease of goods from item 3	a supply made by way of lease if: <ul style="list-style-type: none"> <li>g) (a) the *recipient is the lessee referred to in paragraph (b) of item 3 of this table; and</li> <li>h) (b) the lease is the lease referred to in subparagraph (ii) of that paragraph.</li> </ul>

(2) An entity is an **Australian-based business recipient** of a supply made to the entity if:

- (a) the entity is \*registered; and
- (b) an \*enterprise of the entity is \*carried on in the indirect tax zone; and
- (c) the entity's acquisition of the thing supplied is not solely of a private or domestic nature.

Note: If a supply is not connected with the indirect tax zone, the Australian-based business recipient may be subject to a reverse charge: see Subdivision 84-A.

(3) This section applies despite sections 9-25 (which is about when supplies are connected with the indirect tax zone) and 85-5 (which is about telecommunication supplies).

(4) This section does not apply to supplies covered by a written agreement in accordance with subsection 57-5(4).