

## Treatment of life insurance companies

Special consolidation rules apply to consolidated groups that have life insurance company members to take into account the special taxation treatment of life insurance companies. These rules are designed to ensure that Division 320 of the *Income Tax Assessment Act 1997* (ITAA 1997), and other provisions of income tax law relating specifically to life insurance companies, continue to apply appropriately to the head company of the group (since it is the only recognised income tax payer in a consolidated group).

Head company is deemed to be a life insurance company

The head company of a consolidated group that has one or more subsidiary members that are life insurance companies at any time during the year is itself deemed to be a life insurance company for income tax purposes. This allows the special provisions in the income tax law that apply to life insurance companies to apply to the consolidated group.

### Application of the single entity rule

The income tax treatment of a consolidated group is based on the single entity rule in section 701-1 of the ITAA 1997. This rule means that a subsidiary that is a life insurance company is treated as part of the head company as long as it is a subsidiary member of the group. The single entity rule, combined with the fact that the head company is deemed to be a life insurance company, allows the head company to:

- establish and maintain complying superannuation/first home saver account (FHSA) assets and segregated exempt assets for the group
- have access to the dividend imputation rules that apply to life insurance companies, and
- be taxed appropriately on its allocation of taxable income, namely the complying superannuation class and the ordinary class.

#### Note

In some circumstances, the single entity rule has caused practical difficulties for the head company in identifying the segregated asset income of each class. To overcome these difficulties, if a life insurance company is a member of the consolidated group, the single entity rule will be disregarded for the purposes of working out the segregated asset income of each class.

→ section 713-510A, ITAA 1997

## Modification to the membership rules

When a group consolidates, all the head company's eligible wholly-owned subsidiaries must normally be included in the consolidated group – this is known as the 'one in, all in' rule. This rule does not apply to a consolidated group that has a member that is a life insurance company.

As a result of special tax provisions, life insurance companies often hold assets in wholly-owned unit trusts or wholly-owned companies. Consequently, the complying superannuation/FHSA assets and segregated exempt assets are the membership interests in those wholly-owned unit trusts or companies.

The application of the 'one in, all in' rule would cause these membership interests to cease to be recognised for income tax purposes. This would mean the practical mechanism used to determine income (including capital gains) that should be taxed at 15% or that should be exempt from tax would no longer be effective.

Therefore, a wholly-owned subsidiary of a life insurance company that has membership interests that, directly or indirectly, are a mixture of complying superannuation/FHSA assets, segregated exempt assets and/or ordinary assets, is precluded from being a member of the same consolidated group. The excluded subsidiary member can be a member of another consolidated group provided all the membership requirements in section 703-15 of the ITAA 1997 are satisfied.

→ 'Modified membership rules for consolidated groups that include a life insurance company', C9-6-510

### Note

In certain circumstances, a life insurance company that joins a consolidated group will have access to transitional measures allowing the life insurance company to rearrange assets of the group so that a subsidiary entity can become a member of the group, without any immediate tax consequences.

→ *Income Tax (Transitional Provisions) Act 1997*, Subdivision 713-L

## Modifications to the cost setting rules

When a life insurance company joins a consolidated group, the cost setting process that applies to a single entity joining a consolidated group (→ Figure 1: Cost setting process on formation and entry in 'Treatment of Assets', C2-1) applies.

However, the basic rules are modified to ensure that the special taxing provisions that apply to life insurance companies continue to apply appropriately in a consolidated environment, and that assets and liabilities that relate to policyholders are not affected by the cost setting process. In particular, modifications need to be made when adding liabilities at step 2 of the entry allocable cost amount (ACA) calculation and when subtracting the value of retained cost base assets at step B of the cost setting process.

→ Taxation Determination TD2005/17

## Modifications to step 2 of the entry ACA

The following policyholder liabilities have a prescribed value as distinct from the amount those liabilities are valued at in accordance with accounting standards:

- Complying superannuation/FHSA liabilities and exempt life insurance policy liabilities are valued at an amount worked out under sections 320-190 and 320-245 respectively at the joining time.
- Liabilities under the net investment component of ordinary life insurance policies (other than policies that provide for 'participating benefits' or 'discretionary benefits' under life insurance business carried on in Australia) are valued at an amount worked out for those liabilities under subsection 320-190(2) as if those liabilities were complying superannuation/FHSA liabilities.

## Modifications to step B of the cost setting process

In addition to retained cost base assets, such as Australian currency, or an entitlement that is subject to a prepayment (see section 705-25 of the ITAA 1997), the following assets are treated as retained cost base assets in the cost setting process:

- Complying superannuation/FHSA assets and segregated exempt assets – as these assets relate to policyholders, this modification ensures that the tax cost of these assets is not reset under the entry cost setting process. The tax cost of these assets, for the purpose of working out the tax cost setting amounts of reset cost base assets (→ step C in Figure 1: Cost setting process on formation and entry, 'Treatment of Assets', C2-1), is the 'transfer value' of the assets just before joining time. Transfer value is defined as 'the amount that could be expected to be received from the disposal of the asset in an open market after deducting any costs expected to be incurred in respect of the disposal' → subsection 995-1(1), ITAA 1997. For all other purposes, the tax cost of these assets is the terminating value of the assets → section 705-30, ITAA 1997.
- Assets held by the life insurance company for the purpose of discharging its liabilities under the net investment component of ordinary life insurance policies (other than policies that provide for 'participating benefits' or 'discretionary benefits' under life insurance business carried on in Australia) – the purpose of this modification is to ensure that the value of assets held on behalf of ordinary policyholders is not reset under the entry cost setting process. The tax cost of these assets, for the purpose of working out the tax cost setting amounts of reset cost base assets (→ step C in figure 1: 'Cost setting process on formation and entry', C2-1), is the transfer value of the assets just before joining time. For all other purposes, the tax cost of these assets will be the terminating value of the assets → section 705-30.
- In certain circumstances, the goodwill asset of a joining entity that is a life insurance company that has demutualised. The tax cost of this asset is the 'embedded value' (under subsection 121AM(1) of the *Income Tax Assessment Act 1936* (ITAA 1936)) at the time of the demutualisation of the

life insurance company, less the net value of shareholders' assets held by the company on that day. This value equates to the goodwill component of the embedded value (as defined in AASB Accounting Standard 1038) of a life insurance company at the time of the demutualisation.

→ 'Modified cost setting rules for consolidated groups that include a life insurance company', C9-6-520

#### Note

Joining and leaving time are taken to be a valuation time for the purposes of Division 320. This means life insurance companies will be required to determine the transfer value of complying superannuation/FHSA assets and segregated exempt assets, and the value of associated liabilities, as required under sections 320-190 and 320-245, immediately before they join or leave a consolidated group. When the transfer value of the assets exceeds the value of their associated liabilities, assets with a transfer value equal to the excess must be transferred from the relevant segregated assets within 30 days of the valuation. When the transfer value of those assets is less than the value of their associated liabilities, assets with a transfer value equal to the shortfall may be transferred into the relevant segregated assets within 30 days of the valuation. This process ensures that the value of complying superannuation/FHSA assets and segregated exempt assets is aligned with the value of complying superannuation/FHSA liabilities and exempt life insurance policy liabilities.

### Transfer of tax losses of the complying super/FHSA class on leaving a consolidated group

When a life insurance company ceases to be a member of a consolidated group in an income year, any tax losses of the complying superannuation/FHSA class and net capital losses from complying superannuation/FHSA assets become losses of the life insurance company just after the leaving time (provided that no other member of the group, at the leaving time, is a life insurance company that has a complying superannuation/FHSA pool).

As these losses are subject to loss quarantining rules, the head company would not be able to utilise the losses – it will not have any future income of the complying superannuation/FHSA class, or future capital gains from complying superannuation/FHSA assets, against which the losses can be applied.

## References

*Income Tax Assessment Act 1936*, subsection 121AM(1)

*Income Tax Assessment Act 1997*, Division 320, as amended by *First Home Saver Accounts (Consequential Amendment) Act 2008*; and subsection 995-1(1)

*Income Tax Assessment Act 1997*, sections 701-1, 703-15, 705-25 and 705-30; as amended by *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 1

*Income Tax Assessment Act 1997*, Subdivision 713-L; as amended by:

- *New Business Tax System (Consolidation and Other Measures) Act (No. 2) 2002*, Schedule 6, Part 1
- *First Home Saver Accounts (Consequential Amendment) Act 2008*
- *Tax Laws Amendment (2010 Measures No.1) Act 2010*, Schedule 5, Part 19

*Income Tax (Transitional Provisions) Act 1997*, Subdivision 713-L; as amended by *New Business Tax System (Consolidation and Other Measures) Act (No. 2) 2002*, Schedule 6, Part 3

Explanatory Memorandum to the New Business Tax System (Consolidation and Other Measures) Bill (No. 2) 2002, Chapter 1

Explanatory Memorandum to Tax Laws Amendment (2010 Measures No. 1) Bill 2010, Chapter 5

Taxation Determination TD 2005/17 – Income tax: consolidation: life insurance: do sections 705-75 and 705-80 of the *Income Tax Assessment Act 1997* apply to a policy liability that has been valued under section 713-520 for the purposes of working out step 2 of the allocable cost amount for a joining entity that is a life insurance company?

AASB 1038 Life Insurance Business

### Revision history

Section C9-6-110 first published (excluding drafts) 2 December 2002 and updated 28 May 2003. Further revisions are described below.

Date	Amendment	Reason
14.7.04	Notes on proposed changes to consolidation rules, pp. 5, 6.	Proposed legislative amendments.
26.10.05	Reference to new taxation determination.	
6.5.11	Addition of note regarding application of single entity rule, p. 1.  Removal of notes on proposed changes to consolidation rules, pp. 5, 6.  References to virtual PST assets and virtual PST liabilities replaced.	Legislative amendment   Enactment of <i>First Home Saver Accounts (Consequential Amendment) Act 2008</i>