

IT 110 - General insurance companies: claims incurred but not reported



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TAXATION RULING NO. IT 110

GENERAL INSURANCE COMPANIES : CLAIMS INCURRED BUT NOT
REPORTED

F.O.I. EMBARGO: May be released

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GENERAL INSURANCE COMPANIES

51(1)

INSURANCE CLAIMS

COMMERCIAL UNION ASSURANCE CO. CASE

OTHER RULINGS ON TOPIC

IT 109

PREAMBLE

The following advice was forwarded to branch offices as a result of the decision in Commercial Union Assurance Company of Australia Ltd v FCT (1977) 77 ATC 4186; 7 ATR 435.

FACTS

2. There were three associated issues in the appeal before Newton J., all of which were decided in the company's favour. Briefly they were:-

- (a) Whether deductions should be allowed for estimates of IBNR's at the end of each year of income, i.e. for estimates of insurance claims where the events insured against had occurred but had not been reported to the company by the end of the year of income.
- (b) If IBNR's were deductible in principle, whether the company had adopted a consistent basis in estimating IBNR's at the end of the year of income and of the preceding year of income.
- (c) Because the company's IBNR estimates included amounts in respect of unreported insured events that had occurred prior to the years under review, whether those amounts were to be excluded from the deductions allowable since they would have been incurred in prior years.

3. The decision of Newton J. in favour of the company in respect of the first issue was not unexpected and, following the further review of the decision, the conclusion has been reached that it would be unassailable on appeal.

4. In view of the judge's acceptance of evidence brought by Commercial Union to the effect that its claims for deduction for outstanding claims in previous years included an element of over-estimation to allow to some extent for IBNR's, there would be little chance of this aspect of the decision being overturned on appeal. The judge's conclusion that the company's method of

calculation of outstanding claims in the first year that IBNR's were separately claimed was merely a refinement of earlier methods is a reasonable one in the circumstances.

5. The correctness of his Honour's conclusions in respect of the third issue is more doubtful. However, that issue is of relatively minor importance once the basic principle of the deductibility of IBNR's is accepted and the judge's approach to it is a logical and reasonable one, at least from a practical viewpoint.

RULING

6. It follows from the acceptance of the Commercial Union decision that claims for IBNR's by insurance companies generally, including resident re-insurance companies, should now be allowed and any undetermined objections and appeals should be determined accordingly. It is not expected that there will be any instances where insurance companies would have calculated IBNR's on an unrealistic or unsupportable basis. Appropriate enquiries could be made if you have reason to doubt the validity of the method of calculation adopted by any particular company and the matter may be referred to this office for final decision if you consider that to be necessary.

7. Where IBNR's are claimed as a separate item for the first time in a year of income it is probable that the companies concerned would have grounds to assert that, like Commercial Union, they had previously over-estimated outstanding reported claims to allow to some extent for IBNR's (cf. the second issue in the Commercial Union case). However, even where that is not the case, the companies concerned undoubtedly would have been claiming for estimates of outstanding reported claims and, as Newton J. observed, the character of the provisions in each year would be the same whether they related to reported claims only or included unreported claims. It will not be necessary in these cases, therefore, where a company has claimed IBNR's as a separate item for the first time in a particular year of income, to reduce the deduction claimed by some amount which ought to have been claimed as IBNR's in the immediately preceding year (except in the extremely unlikely event that an insurance company has operated for a number of years without ever claiming deductions for outstanding claims of any kind).

8. It is considered that the decision of Newton J. has no application beyond the matters with which it dealt, viz., IBNR claims by insurance companies. His Honour was able to reconcile his decision with that of the High Court in Flood's Case in a satisfactory manner and, to the extent that taxpayers with current appeals concerning deductions claimed for long service leave provisions etc. may attempt to rely on the Commercial Union decision, the Commissioner will be arguing that the latter case is distinguishable.

COMMISSIONER OF TAXATION