



Insurance Council
of Australia



30 September 2022

Mr Cullen Smythe
Commissioner of State Revenue
Executive Director, Technical Advisory Services
Revenue NSW
4 Parramatta Square, 12 Darcy Street
PARRAMATTA NSW 2150

By email: cullen.smythe@revenue.nsw.gov.au

Dear Commissioner,

Administration of NSW Penalty Regime – Reasonable Care

The Insurance Council of Australia¹ and Financial Services Council² are the representative bodies for general insurers and life insurers (collectively, the **Insurance Industry**) in Australia.

We refer to our meeting with you on 16 June 2022 at the NSW Finance Minister's offices to discuss RevenueNSW's approach to administering the new penalty provisions contained within the *State Revenue and Fines Legislation Amendment (Miscellaneous) Act 2022 [NSW]* (**NSW Penalty Regime**).

At that meeting the Insurance Industry expressed its concern in relation to the NSW Penalty Regime. The concern was that application of the "significant global entity" concept when paired with the doubling of penalties could, on a strict legal approach, lead to disproportionate and inappropriate penalties when applied to high transaction volume state taxes, such as those levied in NSW on the Insurance Industry. To address that concern you undertook to provide specific guidance to the Insurance Industry as to the circumstances in which RevenueNSW will remit penalties where the insurer can evidence that it has exercised reasonable care.

The Insurance Industry thanks you for your constructive approach to help resolve the industry's concerns.

¹The Insurance Council is the representative body of the general insurance industry in Australia and represents approximately 89% of private sector general insurers. As a foundational component of the Australian economy the general insurance industry employs approximately 60,000 people, generates gross written premium of \$59.2 billion per annum and on average pays out \$148.7 million in claims each working day (\$38.8 billion per year).

² The FSC is a peak body which sets mandatory Standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services.

The financial services industry is responsible for investing more than \$3 trillion on behalf of over 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange, and is one of the largest pools of managed funds in the world.

As the agreed next step to implementing this solution, we attach in **Appendix 1** realistic worked examples illustrating circumstances in which the Insurance Industry considers an application, or not, of the significantly increased penalties under the NSW Penalty Regime is appropriate, or not, taking into account:

- the regulatory objective of penalties in promoting good compliance behaviour from the insurance industry; and
- the particular challenges posed to the industry given the design of relevant taxes, the high volume, low-value nature of processing of premiums, the complex combinations of life benefits and policies, and having to deal with multiple jurisdictions with different rates and bases and legislative interpretations.

We look forward to meeting with you to discuss the principled basis on which the worked examples were developed, as a next step in the development of your guidance.

As a part of that discussion the industry considers there is merit in RevenueNSW also establishing a *de minimis* error correction limit below which insurers are able to self-correct minor errors in the subsequent return and in relation to which the Commissioner will remit Penalty Tax in full. This option is advanced as a productivity measure in circumstances where the economic cost of voluntarily reporting a minor error is disproportionate to the penalty. As a starting point for consideration, we suggest that the *de minimis* be set at 1% of the entity's annual duty payable.

The insurance industry is committed to working with you on this process. If you have any questions or comments in relation to this matter, please contact Michael Potter, Policy Director, Economics & Tax, on telephone: 02 8235 2520 or email: mpotter@fsc.org.au.

Yours sincerely



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Appendix 1

Worked Examples – Reasonable Care

Reasonable Care Examples

1. Error type: System configuration error resulting in incorrect classification

Facts

Sage Australia Life Limited (SALL) is a life insurer and a significant global entity (SGE). In December 2020, SALL launched a new retail product which was added to its onsale Policy Administration System (PAS). SALL's internal tax team includes Jacinta, an experienced inhouse insurance duty tax practitioner. Jacinta reviews the new product's benefits and advises the IT change team on the appropriate classifications for each State and Territory. On rollout of Series A of the product, all Total and Permanent Disability (TPD) connected benefits are configured to be life insurance riders, and in NSW duty is charged at 5% of the first year's premiums.

In December 2021, SALL launched a further version of the product (Series B), and all connected benefits are treated in the PAS in the same way as the original product.

In December 2023, Jacinta conducted an internal compliance review of the PAS. This review identified that one Series B connected benefit did not meet the criteria set out in RNSW ruling DUT048, and had been inadvertently coded as a life insurance rider. As a result, there was a duty shortfall of \$250,000 across the two previous years. SALL makes a voluntary disclosure. SALL can demonstrate good tax governance through its internal policies and practices, and a good record of cooperation with state revenue authorities.

Possible application of penalties

RevenueNSW takes a holistic approach to determining whether or not to impose Penalty Tax³. Under this approach RevenueNSW takes into account the insurer's approach to duty compliance, and whether it can demonstrate that it has exercised reasonable care in relation to meeting its monthly insurance duty compliance obligations. Under this approach the existence of a recurring error for 24 months, or a high dollar error amount, does not of itself indicate a lack of reasonable care by an insurer.

RevenueNSW decides, on balance, not to impose Penalty Tax on SALL in relation to this inadvertent system's error. RevenueNSW also took into account SALL's practice of conducting classification reviews every two years, and that it was unable and/or did not seek to recover the underpaid duty from customers.

2. Error type: Overstated credits – 30 day rule not configured into PAS

Facts

In September 2020, Australian Mutual Life Society (AMLS), a life insurer and a significant global entity (SGE), acquired Stateside Life Co (SLC). Thereafter AMLS operates the two life companies simultaneously, each with its own separate Policy Administration Systems (PAS).

AMLS' internal tax team includes Sabrina, an experienced inhouse insurance duty tax practitioner. AMLS has good tax governance processes, which includes conducting a review of the duty rates in its PAS every year. AMLS has a good record of co-operation in audits with different Revenue Authorities,

³ The term Penalty Tax is used throughout this document to refer to the imposition of penalty tax in respect of certain tax defaults under section 26, *Taxation Administration Act 1996 (NSW)*.

and which have identified occasional compliance errors resulting in both under- and overpayments of duty in the preceding five-year period.

In September 2022, AMLS identified, during an internal audit, that the PAS of SLC was configured to claim duty credits on all refunds of premium. Further, this PAS had not been configured by SLC to restrict credits arising from the 30-day rule for policyholders in two relevant States (NSW and Tasmania). From the time of acquisition of SLC, Sabrina had not had sufficient resources to review the SLC PAS. This was due to the prioritisation of other integration issues (including the Part 9 transfer) and other time bound legal compliance requirements as a result of the acquisition. After identification of the 30 day issue, AMLS established a project team to correct the system specifications' defect of this PAS and to quantify the overclaimed duty credit error.

Possible application of penalties

RevenueNSW takes a holistic approach to determining whether to impose Penalty Tax. Under this approach RevenueNSW recognises that the situation where an entity inherits the errors created by a previous owner is fraught with difficulty. RevenueNSW takes into account the level of internal resources, the additional work and its prioritisation occasioned by an acquisition, the insurers compliance approach, the geographic spread of the error (here a constraint on duty refunds limited to two jurisdictions only), as well as the length of time taken to review the PAS of an acquired insurer.

RevenueNSW decides, on balance, to remit Penalty Tax in full for the underpayment duty caused by the inadvertent error of SLC, noting that the particular duty rules for NSW in this area are not replicated across all the states, and could give rise to anomalies within systems' configurations regarding the claiming of refunds. RevenueNSW also accepts that customers had been refunded premium, and that the legislative provision had the impact of restricting credits in certain situations, leaving the insurer to wholly fund the error amount.

3. Error type: Return preparation process error corrected in a later return

Facts

Home Safe Insurance Australia (HSIA), a general insurer and a significant global entity (SGE) lodges monthly insurance duty returns. In July 2023, HSIA identifies, during the preparation of the Annual FY 2023 return, that premiums received during April 2023 relating to its Home Insurance product were inadvertently omitted from the April 2023 insurance duty return. The error was caused by a change in the reports used by HSIA's finance team to prepare insurance duty returns. As a consequence, HSIA omitted duty of \$50,000 in April 2023.

HSIA wishes to remit the unpaid insurance duty as soon as possible. HSIA includes the duty of \$50,000 in its return for the month of July 2023.

Possible application of penalties

RevenueNSW takes a holistic approach to determining whether or not to impose Penalty Tax, including in relation to interest on the tax default. RevenueNSW could impose Penalty Tax for the tax default which occurred in April 2023. If the tax default was considered to arise from a failure to take reasonable care, a penalty rate of 50% of the duty not correctly remitted in April 2023 could be applied. This could result in a penalty of \$25,000.

RevenueNSW decides, on balance, to remit the Penalty Tax in full noting the action taken by HSIA to correct the underpayment of duty as soon as possible after it had identified the error. RevenueNSW considers that interest for the late payment of duty would be more appropriate, noting that the amount would be approximately \$1,125 (interest for 3 months at 9% p.a).

4. Error type: Reliance on third-party data (Example A – Group Scheme Life policy)

Facts

In January 2022, Whole-of-Working-Life Life Insurance (WWLLI), a life insurer and a significant global entity (SGE), enters into an arrangement to provide life insurance to members of the Badger Superannuation Trust. As a part of the group scheme arrangement, the administrator agrees to provide the duty file to WWLLI on a monthly basis. Group schemes typically involve a tripartite arrangement where each party has specified obligations to each other⁴.

The duty file received contains details such as policy number, state of domicile, premium, risk commencement date etc. However, due to the volume of this information the data is only provided at a summarised level and not at an individual policy level. Based on the file, WWLLI calculates duty payable on this group scheme, which is combined and paid with other duty amounts owed.

In September 2022, the administrator of Badger Superannuation Trust Some sends WWLLI an updated file. The reasons for the update were to amend incorrect parameters included in the original file, to update individual information, and rectify system errors within its administration systems. WWLLI recalculates the duty liability and pays an additional \$250,000 of duty under a Voluntary Disclosure Obligation (VDO).

Possible application of penalties

RevenueNSW takes a holistic approach to determining whether or not to impose Penalty Tax. This approach includes taking into account whether the initial underpayment of duty was due to factors outside the control of the insurer, and whether the late payment is made under a VDO

RevenueNSW decides, on balance, to remit the Penalty Tax in full. RevenueNSW reaches this conclusion as WWLLI does not have any control or influence over the data provided the group scheme administrator and the WWLLI reasonably relied on the information in good faith to calculate the duty payable.

5. Error type: Incorrect application of previous audit findings

Facts

Regal Life Insurance (RLI), a life insurer and a significant global entity (SGE), offers life insurance to the public. In June 2017, it was issued with an audit findings opinion by the Revenue Authority in West Australian (WA) Revenue Office. Contained in that opinion was that apportionment methodology adopted by RLI to apportion premiums between the states was not appropriate and resulted in an incorrect allocation to WA.

RLI accepts the position outlined and pays the shortfall identified by the WA Revenue Office.

RLI did not address the findings of the WA Revenue Authority and cap the issue across all states.

Stacey joined the RLI tax team in March 2022. She uncovers the audit findings letter and upon an internal review identifies that nothing had been done. Stacey works to correct the apportionment methodology going forward and also seeks external advice from one of the larger accounting firms, ABC

⁴ Typically, the contact for insurance is between the insurer and the fund's trustee or the employer. Quite often, an external independent administrator, at arm's length to the insurer, is engaged to manage the scheme and is the primary contact between with the individual. The administrator is the primary contact with the insurer. All individual specific data is largely collated, managed and maintained by administrator

Accountants Pty Ltd. They endorse the position she has now taken and issues a formal advice confirming this.

Stacey makes a VDO for the past in December 2023 with the Revenue Authorities across Australia. The NSW Revenue Authority makes an assessment over the VDO.

Possible application of penalties

RevenueNSW takes a holistic approach to determining whether or not to impose Penalty Tax, this includes whether the insurer has promptly acted upon an audit finding.

RevenueNSW decides to impose a level of Penalty Tax. RevenueNSW decides that not acting upon an audit finding by a Regulator for a five-year period meant that RLI did not exhibit reasonable care. Had the internal and external actions undertaken by Stacey happened within a reasonable timeframe of the 2017 audit, say within two years, then reasonable care may have been exhibited in that case. RevenueNSW acknowledges that an SGE insurer may need time to adopt changes arising as a result of an audit, but changes must nevertheless be adopted within a reasonable timeframe, unless other factors dictate otherwise.

6. Error type: Reliance on third-party data (Example B – General Insurance Broker)

Facts

Trust Me Brokers (TMB) recommends products for a range of insurers including Home Safe Insurance Australia (HSIA), a general insurer and a significant global entity (SGE). On 1 March 2023, TMB made a system change which incorrectly reduced the insurance duty rate on a contents cover sold in NSW to the Type B 5% rate.

TMB corrects the contents cover duty rate to 9% with effect from 1 June 2023 for new policies. TMB also informs HSIA that the insurance duty reported on contents cover sold from 1 March 2023 to 31 May 2023 was incorrectly calculated and collected by TMB from policyholders.

TMB is under an obligation to exercise reasonable efforts and diligence in preparing monthly premium borderaux. TMB is aware of HSIA's reliance on the premium borderaux for financial and tax reporting, including statutory reporting for Insurance Duties, Emergency Services Levies and Goods and Services Tax.

TMB provides an amended premium borderaux which corrects the premium transactions reported to HSIA for the period from 1 March to 31 May 2023. HSIA includes the additional premium and duty reported by TMB in its June 2023 monthly duty return.

In September 2023, HSIA receives notice of an investigation on insurance duty and discloses to the Revenue Authority the delayed payment of insurance duty which arose from its reliance on data provided by TMB.

Possible application of penalties

RevenueNSW takes a holistic approach to determining whether or not to impose Penalty Tax. This approach includes taking into account whether the initial underpayment of duty was due to factors outside the control of the insurer, and whether the late payment is made as a part of a subsequent monthly return.

RevenueNSW decides, on balance to remit the Penalty Tax, given HSIA has reasonably relied on the data provided by TMB. The system change led to the tax default by HSIA for month of March 2022 was in the control of TMB. HSIA pays the July 2022 monthly assessment is paid in August and this reflects the correct duty collected from the customer and paid to TMB.

7. Error type: Classification error (reliance on internal advice)

Facts

Major League Insurance (MLL) is a general insurer and a significant global entity (SGE). In April 2022, MLL changed a component of additional cover to their comprehensive car insurance product to gain competitive advantage. MLL did not charge an additional premium for this additional cover. MLL's tax team includes Rasheen, an experienced and inhouse insurance duty tax practitioner. Rasheen reviews the premium change and concludes by documenting that the comprehensive car insurance includes the additional cover and is Type B insurance and that a 5% insurance duty rate applies to the entire premium.

In October 2022, RevenueNSW commences an investigation of MLL. RevenueNSW reaches a different view to Rasheen's documented view. RevenueNSW concludes the additional cover should attract a Type A 9% insurance duty rate. RevenueNSW requires MLL to undertake an apportionment of premium and issues payment notice for the additional duty.

Possible application of penalties

RevenueNSW takes a holistic approach to determining whether or not to impose Penalty Tax, this includes taking into account the level of care taken, the quality and contemporaneous nature of internal advice and documentation, and whether the conclusions reached were reasonable and coherent, notwithstanding that RevenueNSW may reach a different conclusion.

RevenueNSW decides, on balance, to remit Penalty Tax in full given these factors.

8. Error type: Reliance on 3rd party data (Small Business Exemption declaration)

Facts

Major League Insurance (MLL) is a general insurer and a significant global entity (SGE). MLL issues policies to NSW small businesses who provide declarations that they are eligible capital gains tax (CGT) small businesses (as defined by the Duties Act and the Income Tax Assessment Act).

MLL has systems in place to collect and keep records of annual declarations by policyholders who attest to their eligibility for the small business duty exemption. MLL also issues policies to clients introduced by Simple Business Brokers (SBB). SBB collects and keeps the records of annual declarations by policyholders for MLL.

In October 2022, RevenueNSW undertakes an audit of MLL insurance duty for the financial years ended 30 June 2019 to 30 June 2022. RevenueNSW identifies several policies where the small business duty exemption has been incorrectly claimed for policyholders who were not eligible capital gains tax (CGT) small businesses.

Possible application of penalties

RevenueNSW takes a holistic approach to determining whether or not to impose Penalty Tax, this includes whether to impose a maximum penalty of \$11,000 on a policyholder if false or misleading information is provided to obtain the State's small business exemption.

RevenueNSW takes into account the insurer's approach to duty compliance, and as MLL can demonstrate that it has procedures to collect and keep declarations made by policyholders (including declarations held by brokers), MLL has exercised reasonable care in relation to meeting its monthly insurance duty compliance obligations.

RevenueNSW decides to remit Penalty Tax in full, as MLL does not have any control or influence over the declarations provided by their customers and has relied on all declarations in good faith to apply the small business duty exemption.

9. Error type: Incorrect return by virtue of notification error for overpaid duty

Facts

Great Life Insurance Ltd (GLIL), a life insurer and a significant global entity (SGE) and commences to offers life insurance to the public in 2017, and premiums are paid monthly. Its main Policy Administration System (PAS) has always been programmed to calculate the annual stamp duty payable at the annual anniversary date of the policy. Accordingly, on the annual anniversary of the policy, the full duty liability for the year was calculated and remitted to RevenueNSW in that anniversary month's duty return. This occurs even where only part of the premium (relating to that annual duty liability) has been received by GLIL at that time. Where the policy is lapsed (due to continuous non-payment of premiums), the PAS was programmed to reverse the calculated amount in the month when this occurred even though no premiums were received.

In March 2023, GLIL's internal Tax team reviews the duty legislative position of the clawback. In April 2023, it obtains advice from its external tax adviser. In May 2023, the external tax advisor advises GLIL that the treatment in the PAS is incorrect as they considered that not all of the "premium" as defined in the relevant section of the Duties Act has been "given" to GLIL, and that any amount of duty calculated by the PAS in excess of premiums received is a mistaken payment and not duty as such. The external adviser has told GLIL that it may seek a refund of that excess amount. Going forward, GLIL calculates duty on the premium received, relying on its internal review and the external advice obtained. Rather than notify RevenueNSW of the mistaken amount, GLIL offsets the excess amount in its July 2023 return.

In October 2023, RevenueNSW commences an audit of GLIL. RevenueNSW identifies the mistaken payment as well as other overpayments of stamp duty that offset the stamp duty payable in the July 2023 stamp duty return. It disagrees with the net position adopted.

Possible application of penalties

RevenueNSW acknowledges that an error has arisen for the stamp duty offset for the overpayment of stamp duty but not for the mistaken payment. Accordingly, the RevenueNSW considers that notification is required for the correction of those overpayments of stamp duty, and this did not occur until the time of the audit. As a result, it was considered that the July 2023 stamp duty return is not correct (that is, it is not correct until such time when the notification has been made to the RevenueNSW).

RevenueNSW considers that notwithstanding that GLIL had not made a notification for the overpayment of stamp duty at the time when the Return was lodged, this was a timing issue only. It accepted that GLIL had been mistakenly overpaying on their Returns for a long period of time in respect of the excess amount. Holistically, RevenueNSW considers that GLIL had not failed to take reasonable care and decides to remit the Penalty Tax in full.

10. Error type: Inadvertent error and refund notification

Facts

Bantam Life Ltd (BLL), a life insurer and a significant global entity (SGE), offers life insurance to the public. In January 2022, BLL starts to offer a 'waiver of premium' rider that can be bundled with the customer's disability / total permanent disability policy – the premium is imbedded into the underlying policy's premium. Under the 'waiver of premium' rider the insured can request that ongoing premiums for their policy be waived once a claim has been made.

Each month Janice, a member of the Tax Team, calculates the duty on the waiver of premium manually, due constraints with BLL's policy administration system (PAS). In May 2023, Janice goes on leave and Heather another member of the Tax Team performs the duty calculations. However, due to an inadvertent error, Heather erroneously includes the premium amount, rather than the duty amount, in the April return.

In June 2023, Janice returns from leave and identifies the error. To rectify the error, BLL self-corrects the error in the May duty return by netting the premium amount less the correct duty amount from the total duty liability for the June 2023 return.

In October 2023, RevenueNSW commences an audit. BLL outlined the reasons for the self-correction and provided evidence to show that the amount that was incorrectly included in the stamp duty return was not the stamp duty amount. RevenueNSW assesses BLL for the self-corrected amount.

Possible application of penalties

RevenueNSW takes a holistic approach to determining whether or not to impose Penalty Tax, this includes whether the insurer has promptly undertaken a self-correction upon identification of an error, notwithstanding that prior approval is not sought.

RevenueNSW decides, on balance, to remit Penalty Tax in full. RevenueNSW considers that although BLII should have sought prior approval it could demonstrate that the incorrect amount was included in the duty return. Accordingly, it considers the BLII had exercised reasonable care.

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