Pre-Budget Report 2006 and implications for Life Assurance

Pre-Budget Report

This year's Pre-Budget Report issued on 6 December 2006 contained significant detail that has implications for the taxation of life assurance companies and Friendly Societies. Below we summarise the key areas likely to be of most interest to life actuaries.

Pension term assurance

A substantial change to the treatment of Pension Term Assurance (PTA) appears to be in the offing. It is no longer clear that tax relief will be available on premiums paid to individual pension term assurances effected from 7 December 2006, including all pipeline cases. The uncertainty introduced complicates future sales of term assurances and could impinge on the operation of this important insurance service. HMRC has said that they “want to work with the industry between now and the Budget to discuss the best way to restrict tax relief for arrangements, which are entered into on or after today, providing lump sum benefits where these are disconnected from wider retirement saving” and we believe many firms are considering putting their PTA offering 'on hold' until the issue is resolved.

It is not however the Government’s intention that any action it may announce in the Budget will affect existing types of occupational scheme, including where the occupational scheme only provides death in service benefits." This seems a little strange given life cover under occupational pension schemes could be viewed as an alternative to a level term assurance policy but receive different tax treatment.

A press release since the PBR has clarified the treatment for pipeline cases. It states that applications completed by 6 December 2006 and recorded as received by 13 December 2006 by the insurance company will be eligible for the existing relief regime provided the policy is in force by 5 April 2007 and there is no increase in the sum assured in the original application.

Further details are available from http://www.hmrc.gov.uk/pensionschemes/pensions-term-assurance.htm

Reserve releases arising from proposals in CP 06/16

The PBR proposed that there will be no requirement to bring into account as taxable profit for 2006 any amount that results from the release of reserves due to the application of proposals in CP 06/16 as part of a 31 December 2006 valuation and the taxation of such profits is being discussed but may be spread over subsequent years.

HMRC responded on 19 December 2006 to the FSA Rule changes implemented in accordance with PS 06/14 having been consulted on as part of CP 06/16. This also covers similar issues affecting reinsurers arising from the rule changes outlined in CP 06/16 and CP 06/12.

HMRC proposes to spread the impact of the significant reserve releases expected as a result of the FSA Rule changes. In order to enable companies and auditors to include the intended tax treatment in their accounts and regulatory returns for the year end 2006, HMRC has laid an Order that satisfies the criterion for the legislative change to be considered "substantially enacted".

The intention of the Order is to defer tax on the profit caused by the release of reserves. HMRC has also indicated that a further Order will be issued in 2007 to spread the impact of the reserve release on taxable profits equally over the 3 years 2007, 2008 and 2009. If a company does not release the reserves until 2008 then 2/3rds of the profit is charged to tax in 2008 with the balancing 1/3rd in 2009. No spreading is available in respect of releases in 2009 and subsequently. Capital adequacy permitting, companies may wish to consider which year to release reserves to optimise their tax position.

Key points for actuaries are:

- The release of mathematical reserves arising from the application of the FSA Rule changes have to be disclosed in the new paragraph 4(12) of the Appendix 9.4 report of the FSA returns.
- Only amounts released in non profit funds are relevant.
- Only amounts not affected by changes in Form 14 line 51 (excess of value of not admissible assets) are relevant. Presumably if the release of reserves is offset to some extent by a change in the "investment reserve" then profit does not emerge to the extent of that offset and so no adjustment is required for that part of the release.

Further details cover company years that are other than calendar years and transfers of business.

Further details are available from http://www.hmrc.gov.uk/si/2006-3387.pdf and http://www.hmrc.gov.uk/si/2006-3387-em.pdf

Current consultations

HMRC launched four strands of consultation affecting life taxation in July 2006. The consultation is ongoing though some details have been progressed and announced in the PBR.

- Legislation affecting transfers of business is to change, removing existing clearance procedures and some of the complex anti-avoidance legislation. It is to be replaced with better targeted legislation with more appropriate clearance focused on the tax effect of the transaction rather than on policyholder taxation.
- PHI business is to remain as a separate tax category but all other gross roll-up tax categories are to be combined into one.
- HMRC plans to increase certainty for companies whose profit exceeds their income (and so would be taxed on an "Actual Case 1" basis).
- The review of apportionment of investment returns in the tax computation is ongoing.

There is also current consultation in relation to Friendly Society business. HMRC has published draft proposals for retaining the tax-exempt status of Friendly Society business on transfer to life companies. Other issues under consultation are also expected to be resolved in accordance with the industry's expectations.

VAT on outsourced administration services

A recent European Court of Justice (ECJ) ruling on VAT potentially reduced the range of VATable outsourced administration services. A subsequent review of this issue by the European Commission is expected to result in a reversal of this position and potentially lead to an extension of tax-exempt administration services. HMRC has indicated that it is continuing to monitor developments before acting on the ECJ ruling.

Miscellaneous

Other points worth noting are:

- ISAs are to be made a permanent savings vehicle and the concept of the mini-ISA is to be removed. In addition it is intended that PEPs, TESSAs and child trust fund accounts (when the child reaches 18) can be rolled into an ISA.
- The favourable tax effect of writing down inadmissible assets is to be reviewed.
- Taxation of "Controlled Foreign Companies" is to be modified following a successful challenge to the current legislation in the European Court of Justice. The intention is to retain the effect of the current legislation to the extent possible.

Further details

Full details are available from the web sites of HMRC and HMT at the following addresses:

http://www.hmrc.gov.uk/pbr2006/index.htm

http://www.hm-treasury.gov.uk/pre_budget_report/prebud_pbr06/prebud_pbr06_index.cfm

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