The Actuarial Profession
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Current Issues in Life Assurance
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Current Life Tax Developments

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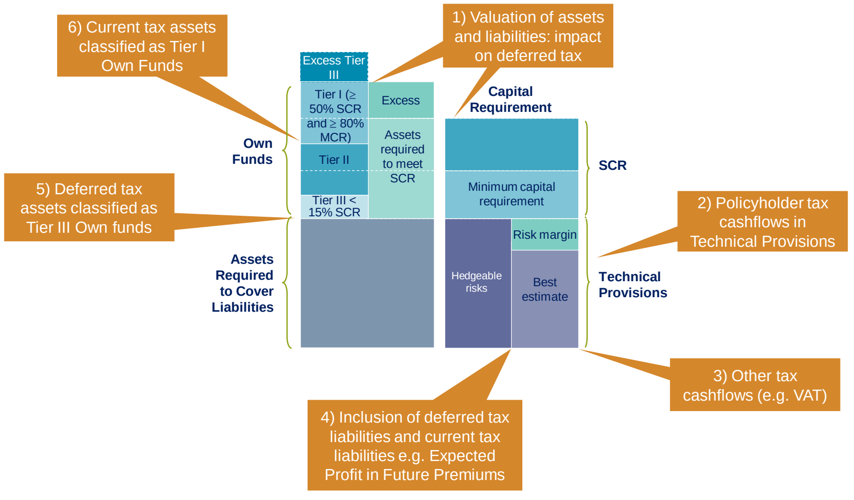
Current Life Tax Developments

Agenda

- Tax and Solvency II
  - How does tax impact Solvency II?
  - QIS5 and Solvency II
  - Tax in Internal Models
  - What accounting basis will you use for tax?
- New Life Insurance Tax Regime
  - Budget Announcement
  - Expected Timetable
- Tax implications of RDR

Where is tax in Solvency II?



Source: CEIOPS

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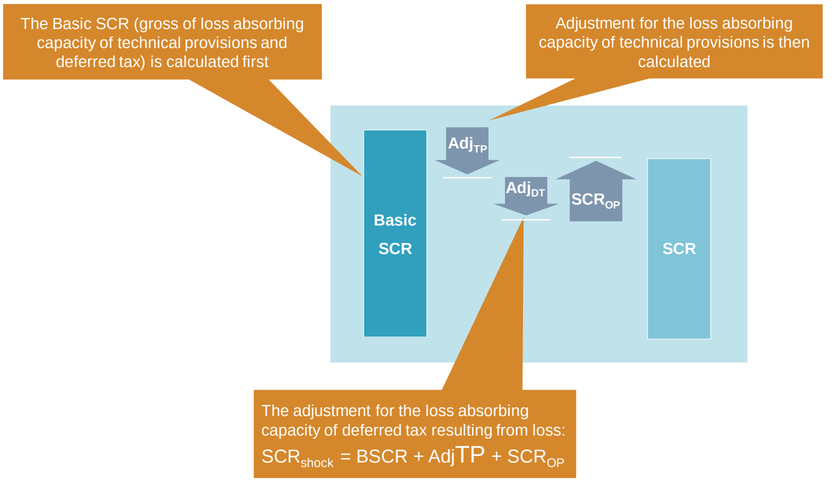
Adjustment for loss absorbency of deferred tax



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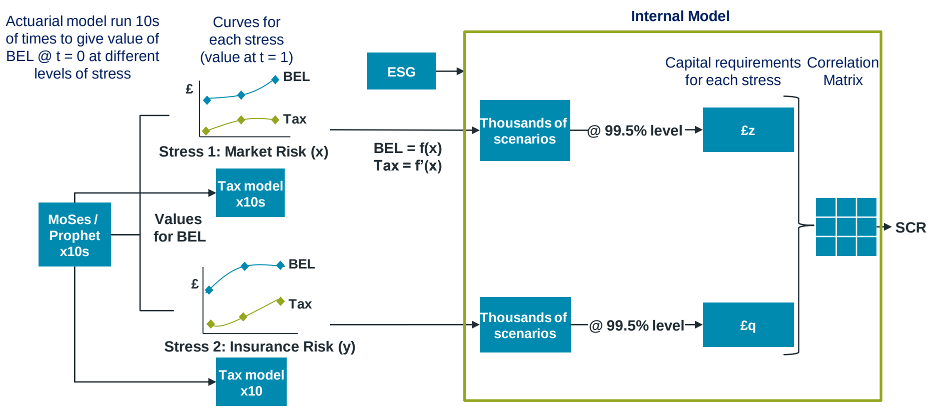
QIS5 and Tax

Loss absorbency capacity of deferred taxes (LACODT)

- Captures the extent to which deferred taxes would be affected in the event of an adverse event. The SCR is reduced to the extent an insurer can be liable to less tax than previously expected.
- Loss absorbency is very material to the overall SCR. Despite this, only about 60% of participants calculated the loss absorbency adjustments.
- For those that did calculate LACODT, the impact was significant.
- The LACODT was on average 19% for Groups.
- The calculation was found to be more complex at the Group level than at Solo level due to multiple taxation regimes.
- Many participants reported a lack of clarity around the methodology, which led to a variety of approaches. Supervisors were also concerned that the realisation of deferred tax assets may not have been properly considered.

Source: EIOPA QIS 5 Results

Tax and the Internal Model – Post-Tax Loss Functions

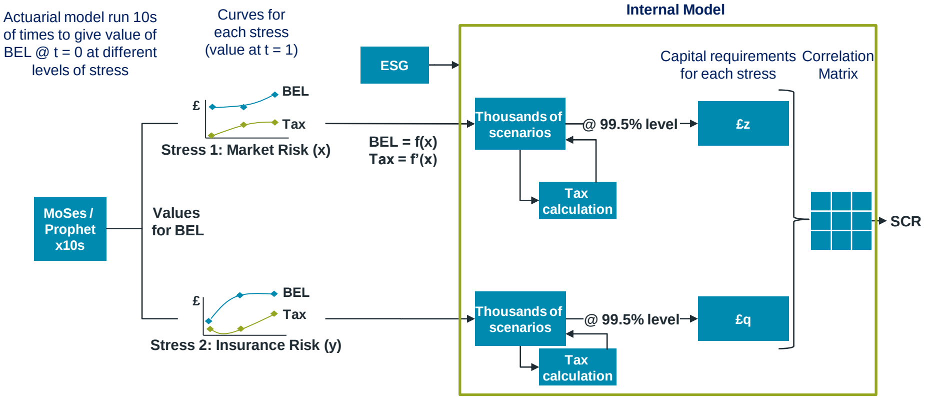


BEL includes some policy into tax. Risk that too much credit for expenses in some scenarios.

These data points effectively define 10s of stressed balance sheets at t = 1.

There is a choice whether to apply tax calculation 10s of times to define a tax function or thousands of times in the IM.

Tax and the internal model – Pre-Tax Loss Functions



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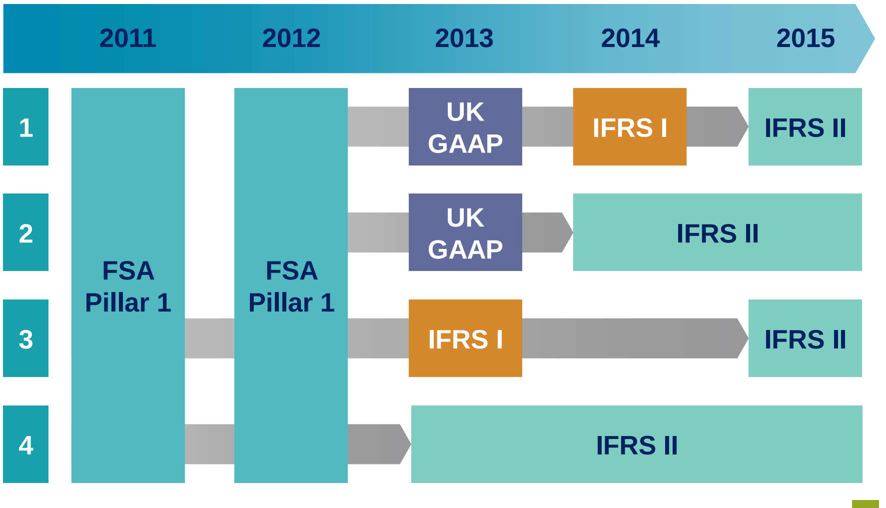
What accounting basis for your tax calculation?



The complexity of the current UK life tax regime is largely driven by three factors

- The I-E system with its dual policyholder /shareholder tax charge
- Regulatory rather than GAAP basis of profit
  - Complex rules (in particular around financing and transfers of business)
- Sub-division of the company by fund and category of business
  - Complex and un-commercial apportionment rules
  - Complex interactions between categories (e.g. on losses)

Key points from Budget announcement

- 1) The future of I-E and the dual policyholder / shareholder tax charge

  I-E system to be retained, however

  - The complex I-E rules will only be applied to BLAGAB, not the whole of the life assurance business
  - New protection business written from 1/1/13 will be excluded from BLAGAB (and the I-E computation). This will end the relief for excess E from such business

  Consultation is continuing on a number of points including on the precise definition of protection and how to mitigate volatility in taxable profits

- 2) The new measure of trading profit for tax

  GAAP profit will be the starting point

  - In particular, the FFA / UDS will be deductible (but there is recognition that this area may need to be revisited post-IFRS Phase II)

    Profits or losses arising on the transition to an accounts basis of taxation will generally be spread over 10 years (but DAC and DIR to follow the unwind in the GAAP accounts)

  The deduction for policyholder tax will be subject to further consultation but the suggestion is that it will be for cash tax only (not deferred tax)

  Any accounting profits or losses arising on intra-group Part VII transfers (post 2013) will be disregarded for tax purposes

  Any accounting profits or losses arising on third party Part VII transfers (post 2013) will be taxed

Key points from Budget announcement

- 3) Sub-division by fund and category

  Only 2 categories of business. GRB, PHI and protection to be merged (with consultation on continuing the exemption for dividends allocated to PHI)

  Interactions between enlarged GRB and BLAGAB effectively ended (with I-E minimum profits machinery applying only to BLAGAB)

  Apportionments will be on a factual / commercial basis as far a possible. May need data from actuaries on assets and actual investment return backing particular products

  Existing GRB losses will be fully available to be set against GRB profits in the new regime (subject to consultation on a streaming rule). This is a favourable outcome for a number of companies. In future, it may be easier to take a deferred tax asset for these losses

  A proportion of brought forward BLAGAB LATP losses at transition will be available for carry forward into the new regime

  Likely that the shareholder fund will cease to be recognised separately from the long term fund. Instead, assets will be classed as being on trading account or capital account on first principles (and existing shareholder fund assets will be grandfathered into the capital category). Accordingly the return from such assets should remain on a chargeable gains or loan relationship basis and not be part of the trading computation

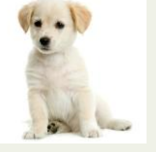
Implications

- Anticipating post 2012 changes in the design of actuarial models being built for Solvency II may be a significant simplification
  - Only 2 categories of business and the enlarged GRB will be taxed on a standalone basis
  - Modelling tax on a product by product basis may be less likely to lead to significant distortions – tax will (largely) follow on accounting and actuarial records rather then apportionment formulae to allocate investment return

  It should now be easier to recognise value for GRB losses in GAAP and EV
- XSE may become scarcer given (i) reclassification of protection and (ii) the end of the GRB/BLAGAB interaction in the I-E. There are potential implications for the recognition of tax assets and the pricing of acquisitions of XSE books
- Several factors may influence the relative attractiveness of a number of insurance and funds products over the next few years
  - Ending of protection/investment tax synergy
  - RDR ends commission payments (and associated tax relief)
  - Not yet clear how roll up of investment return on while of life policies will be taxed

  As for large companies generally, the CT rate will now fall to 23% in 2014 (previously 24%) so the rate differential between shareholder and policyholder profits will reduce

Expected timetable for final rules & other matters

The path to the new regime	
23 March 2011	Budget day, 15 page Technical Note published
5 April 2011	Consultation paper published & programme of open meetings announced
28 June 2011	Consultation closes
Q4 2011	Draft legislation expected
2012	Budget announcements and Finance Act
January 2013	New rules take effect  OR ? 

Tax implications of RDR

Number of tax considerations

- tax relief in I minus E on BLAGAB business
- VAT analysis of ‘separate’ advice charge
- need to consider policyholder taxation implications of revised charging structures
- particular implications for Pensions products