Taxation of Life Assurance Companies – Old and New Basis Regimes

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Introduction

The purpose of this manual is to set out the treatment of old basis and new basis business for life assurance companies.

The majority of life companies will have a mixture of old basis and new basis life business and the tax computation will be on the I-E regime for old basis business and on a Case I regime for new basis business. Ultimately, when the old basis business has become negligible, the new basis regime will be fully operational for all types of business.

1 Taxation of life assurance companies

Section 53 Finance Act 2000 introduced Chapters 4 and 5 into Part 26 of the Taxes Consolidation Act (TCA) 1997. Chapter 5 deals with the “new basis” exit-tax regime. Chapter 4 (including changes made by Finance Act 2001) brings all life assurance companies within a Case I taxing regime, but keeps domestic life business within the I-E provisions (the “old basis”) to the extent that it relates to life policies written before 31 December 2000.

Therefore, the tax treatment of life assurance companies varies depending on when the life assurance business was contracted.

- Life assurance business contracted on or before the 31 December 2000 is referred to as “old basis business”.
- Life assurance business contracted on or after the 1 January 2001 is referred to as “new basis business”.

2 Old Basis Business

Life assurance business written on or before the 31 December 2000 is taxable under an aggregate system known as the I-E (or income less expenses) system. The I-E tax computation in respect of old basis business is based on investment return (i.e. Case III, Case IV, Case V and Chargeable Gains) as opposed to trading profits. The investment return is apportioned between policyholders and shareholders.

- The shareholders’ share of profits are taxed at the standard rate of Corporation Tax (currently 12.5%).
- The policyholders’ share of profits are taxed at a Corporation Tax rate equal to the standard rate of income tax (currently 20%).

3 New Basis Business

Life assurance business written on or after 1 January 2001 is taxable on a segregated gross roll up scheme. The new regime charges "new basis business" life assurance companies to tax under Case I of Schedule D. Such business is:

- The policies of domestic life companies commenced on or after 1 January 2001 together with such companies' existing pension business, general annuity business and permanent health business (so far as already taxed under Case I of Schedule D);

- All policies of International Financial Services Centre (IFSC) life companies, commenced on or after 1 January 2001; and

- All policies of new life companies set up on or after 1 April 2000, unless such company elects under section 730A(2) TCA 1997 to have its policies commenced prior to 1 January 2001 taxed on the "old basis".

Sections 730A(3) and 730A(4) provide that new basis business is to be treated as a separate business whose profits are to be computed in accordance with and charged to tax, under Case I of Schedule D. Section 730A(5) TCA 1997 provides that in making the Case I computation a deduction is allowed for amounts allocated to policyholders but not in respect of amounts reserved for policyholders.

The shareholder profit is taxed using normal Case I rules.

The growth in the policyholder funds is not subject to an annual tax. However on the happening of a chargeable event, Irish resident policyholders are subject to an exit tax on the growth in value of the policy at 41% or at 60% in the case of personal portfolio life assurance policies.

3.1 Case I Computation

The basis of computation will be the transfer to the non-technical account.

A proportion of the transfer to the fund for future appropriation ("FFA") will be regarded as taxable shareholder profits with the balance treated as belonging to policyholders. The proportion of the transfer to FFA which will be regarded as shareholder profits will be that proportion which represents the upper limit under the company's constitution which may be allocated to shareholders out of any surplus, but subject to a minimum or 'floor' of 5% of the transfer. In the case of negative transfers to the fund, the same proportion will be deductible but only to the extent that the cumulative transfers from 1 January 2001 exceed the value of the fund as at 31 December 2000.

The annual transfer to the shareholder non-distributable reserve will be taxable - it is allocated fully to shareholders.

Normal add-backs/deductions for tax purposes will be made.

A deduction will be allowed in respect of Irish dividend income included in shareholder profits. This will be calculated as follows:

Total Irish Dividend Income	X	Profit on Activities
Total Technical Income		(per non-technical a/c)

The following graphic illustrates the position:

	Transfer from technical account	X
Add	Taxation	X
		X
Add	Investment Income	X
	Profit on Ordinary Activities	X
Add	Transfer to fund for future appropriations	X
	Normal add-backs	X
Less	Normal deductions	X
	Capital Allowance	X
	Irish Dividend Income	X
	Taxable profits	X
	Tax payable	X
Less	Tax deducted at source	X
Credits	Double Tax Relief (net basis	X
	Net Tax Liability	X

Notes

1. Technical Income: This is the gross income per the technical account comprised of the following:
   - Earned Premiums net of reinsurance;
   - Investment Income;
   - Gains on Investments;
   - Any other technical income
2. The reference in the graphic to 'investment income' is a reference to the investment income taken directly to the non-technical account.
3. Total profits will now be assessed under Case I of Schedule D, except for the exceptional circumstances where shareholder assets are disposed of. In that case CGT will apply (e.g. disposal of assets which are not part of the Insurance funds).

Section 17 of the Finance Act 2017 amended section 730A(5) TCA 1997 to provide that a life company cannot use foreign tax arising on income that forms part of its 'policy holder business' to claim double tax relief against its taxable profits.

3.2 Mutual Companies

5% of the transfer to the fund for future appropriations will be deemed to be profits chargeable under Case III at the trading CT rate.

5% of negative transfers from the FFA can be carried forward against the deemed profits of the following year or carried back against the deemed profits of the preceding year.

In the case of a company trading in the State through a branch/agency, the Irish deemed profits will be:

$$5\% \text{ of transfer} \times \frac{\text{Irish Mean Liabilities}}{\text{World-Wide Mean Liabilities}}$$

In view of the fact that the FFA is concerned solely with "with-profits" policies the numerator and denominator in the above fraction will exclude non with-profits business.

Capital Allowances can be set against deemed profits under Case III.

4 Mix of New Basis and Old Basis Business

4.1 Case I Computation - Proprietary Companies

Case I - The total Case I will be calculated on the basis outlined above. However the computation will be adjusted to extract the profits attributable to the 'old basis' business. The methodology would be to attribute income and expenditure into each category to the extent that such income/expenditure is identifiable. Where income/expenditure cannot be the subject of specific attribution e.g. general expenses, capital allowances, then they will be allocated by reference to actuarial valuation. In practice each company will submit a computation with accompanying notes on specific items, as appropriate.

The following is an illustration of the position:

€Millions	Old Basis	New Basis	DETE Total	Old Basis	New Basis	Accounts Total
Premiums	70	30	100	70	30	100
Investment Income	40	10	50	40	10	50
Expenses	(5)	(25)	(30)	(5)	(10)	(15)
Claims	(20)	(5)	(25)	(20)	(5)	(25)
Movement in Reserves	(65)	(20)	(85)	(65)	(20)	(85)
Surplus/Profit	20	(10)	10	20	5	25
DETE Transfer	25	(10)	15	N/A	N/A	N/A

Assume that the above example represents the position after a few years into the new regime by which time, say, shareholder tax is 12.5% and standard rate tax is 20%. The company only writes Old Basis business and New Basis business i.e. no pensions or PHI etc. The totals for DETE and for the Accounts bases are from the audited respective annual returns.

It is assumed for simplicity that the only material difference between the two bases is in the treatment of acquisition expenses, these being deferred under the Accounts basis. We also ignore any FFA complications.

The following comments are made in respect of the allocation between Old Basis and New Basis:

- Premiums will be actual.
- Investment Income will be actual or mean fund based or a mixture of both.
- Expenses will be attributed using similar techniques as are currently used to attribute between pension and life business.
- Claims would be actual.
- Movement in Reserves would be actual.
- Surplus or Profit would then fall out from these allocations.
- It would seem appropriate that the DETE Transfer would be allocated in proportion to Surplus, but restricting any negative transfer on the new basis to the level of negative surplus.

In deriving the tax computation we ignore second order adjustments and in particular we assume that the NCI would equal the DETE Transfer. Accordingly the tax computation would be as follows:

Old Basis: I - E = 35 of which 25 (NCI) is taxed at 12.5% and 10 is taxed at 20%.

New Basis: 5 is taxed at 12.5% (policyholders will have been debited with any exit taxes due).

Tax deducted at source - This will follow the relevant attribution of investment income.

Double Taxation Relief (DTR) - Again this will follow the relevant attribution of investment income and therefore the amounts of DTR available under each system should be readily available. For new basis business DTR will be available at the CT rate only in respect of the following:

(i) Investments attributable to new basis life business investments.

(ii) Investments attributable to Pension, Annuity, and PHI (if already Case I).

Any excess credit will be treated in accordance with the general rules applicable to DTR.

4.2 Pension Annuity Business ("PAB") and General Annuity Business ("GAB") Case IV

These are to be integrated into Case I going forward. The question of the allowability of pre-31 December 2000 losses arises. It is proposed to deal with these as follows:

- To allow for carry forward of PAB losses to the extent that they can be shown to relate to "unit-linked" business. In the case of non-linked business losses will only be allowed forward to the extent that the valuation of assets in the Case IV tax computation is consistent with the valuation of liabilities in the tax computation. Any other PAB losses are seen as essentially due to timing and therefore adequately covered by the untaxed portion of the FFA.

- To allow carry forward of GAB losses as reduced by any Foreign Fund Relief previously allowed.

4.3 Permanent Health Insurance (PHI)

To allow any losses forward into the new regime, where PHI previously assessed under Case I of Schedule D.

4.4 Mutual Companies

- Deemed profits chargeable under Case III (as outlined above) to be reduced by the proportion of the FFA transfer attributable to 'old basis' business. In practice, each company should submit notes outlining the methodology used for attribution between new and old business.

- PAB & GAB losses to be allowed on the same basis as for proprietary companies.

- 15% of negative transfers to the FFA will be deductible only to the extent that the cumulative transfer from 1 January 2001 exceed the value of the fund as at 31 December 2000 and in so far as they relate to new basis business.

4.5 I-E Basis

This will continue for 'old basis' life business.

4.6 IFSC Companies

The new basis for calculation of Case I profits was effective from 1 January 2001. A separate charge for shareholders investment income no longer applied from 1 January 2001 and accordingly the losses forward were available against all IFSC profits.

IFSC and domestic business continued to be treated as separate trades for tax purposes. The provisions of Section 730A(3) TCA 1997 as they apply to IFSC companies are to be interpreted as preventing the set-off of IFSC losses against domestic business written from 1 January 2001, but not over-riding the legislation already in place as regards business written under the IFSC certificate.

4.7 Industrial Branch Business (IB)

All IB business falls within "old basis" business, including business written on or after 1 January 2001.