KPMG

Hong Kong (SAR) Tax Alert

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Taxation arrangements for Hong Kong insurers following the adoption of Risk-based Capital Regime

Summary

The draft legislation providing a legal framework for the implementation of the Risk-based Capital ("RBC") regime for the Hong Kong insurance industry was introduced to the Legislative Council ("LegCo") and had its first reading on 19 April 2023. Included in this legislation are some important changes to the taxation position for Hong Kong insurers following the adoption of RBC regime.

At present, a rule-based capital adequacy regime is adopted for those carrying on an insurance business in Hong Kong. This approach assesses an insurer's capital adequacy for long term business and general business on the basis of its solvency margin, which is linked to the amount of premium income and level of insurance liabilities. However, this regime does not take into account pertinent factors related to the business and risk management practices of each individual insurer, such as potential risks associated with the nature of products offered and with investments made.

The proposed RBC regime takes a modular approach for an assessment that is more sensitive to each insurer's risk profile consisting of market risk, life and general insurance risks, operational risk, etc. Under this approach, insurers with solid risk management measures as well as better asset and liability management will shoulder lower capital requirements. On the other hand, insurers exposed to high risks have to possess more capital to protect policyholders.

The Insurance (Amendment) Bill 2023 was introduced to LegCo for first reading on 19 April 2023.

Taxation arrangement under the RBC regime

As the valuation method for determining an insurer's liabilities will change under the RBC regime, there are Hong Kong Profits Tax implications for those insurers whose assessable profits are calculated with reference to these liabilities. The Bill contains various proposed amendments to the Inland Revenue Ordinance (Cap 112) ("IRO") to address the corresponding tax issues. Some of the key amendments are highlighted as follows:

- **Section 23** is amended to refine the ascertainment of the adjusted surplus for those taxpayers who have elected to that basis for computing the assessable profits from **life insurance business**.
- **Section 23AAA** is added to provide for the ascertainment of assessable profits from **non-life long term insurance business.**
- **Sections 23AAAB to 23AAAE** are added to provide for the spreading of any one-off increase in assessable profits due to the adoption of the RBC regime over **a period of 5 years** for **life insurance business and non-life long term insurance business.**

- **Sections 23A and 23AB** are amended to adjust the ascertainment of assessable profits from **general insurance business** and **general reinsurance business**, etc. respectively due to implementation of the RBC regime.
- **Section 23AD** is added to provide for the spreading of any one-off increase in assessable profits due to the implementation of the RBC regime over **a period of 5 years** for **general insurance business**.

KPMG observations

Transition to the RBC regime is imminent for the Hong Kong insurance industry and this represents a hugely significant regulatory change for the industry. We welcome the Government taking account of industry feedback and proposing a spreading over of 5 years for any one-off increase in assessable profits following the adoption of RBC regime. This is particularly important for industry participants who early adopt the RBC regime.

However, there are still matters that either have not been addressed or require more certainty as the Bill progresses to the Bills Committee, including:

- The specific mechanism(s) to “de-consolidate” the financial results of an insurance group in the RBC reports to facilitate the Hong Kong Profits Tax filing;
- The impact of the proposed rules on long standing tax treatments adopted by insurers for certain parts of the business and / or certain types of income; and
- Application of the arrangement for early adopters, specifically for insurers of transitioning to the RBC regime part way through a basis period.

Apart from the Profits Tax concession introduced to certain insurance-related businesses in 2021, the relevant sections within the IRO applicable to insurers have not had significant reviews over the past years. Given the draft amendments have introduced a number of new concepts and definitions impacting how insurers should be taxed in Hong Kong, relevant taxpayers should review their RBC implementation status as well as estimating the potential financial impact it brings to them following the adoption of the RBC regime.

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