Tax Alert

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IRAS publishes Guidelines for taxation of insurers due to the changes made to the Risk-Based Capital (RBC) Framework

Introduction

On 14 August 2020, the Inland Revenue Authority of Singapore (IRAS) issued the new e-tax guide (Guidelines) for taxation of insurers due to the changes made to RBC Framework. The new Guidelines were issued following the revised RBC Framework (also referred to as RBC 2 Framework) issued by Monetary Authority of Singapore (MAS). This tax alert provides a summary of the changes under the RBC 2 Framework which will impact the taxation of insurers.

Background

MAS introduced the RBC Framework (also referred to as the RBC 1 Framework) in 2004 and the purpose of the RBC 1 Framework is to adopt a risk-focused approach to assessing capital adequacy of insurers and seeks to reflect the risks faced by the insurance companies.

Considering the evolving market practices and global regulatory requirements, MAS has conducted a review of the RBC 1 Framework to ensure that it aligns with international standards and best practices. In addition, this ensures that the Framework for assessing capital adequacy will be more aligned to the insurer's business activities and risk profiles. MAS has thus completed its review and issued the RBC 2 Framework which took effect on 31 March 2020. Early adoption is not permitted.

Not withstanding the changes made to the regulatory Framework by MAS, the IRAS will maintain the existing tax treatment for insurers. In addition, the policy liabilities which are computed in accordance with the RBC 2 Framework will be accepted for tax purposes. The changes arising from the RBC 2 Framework are set out below.

Tax treatment on the amount of policy liabilities as computed under the RBC 2 Framework

The existing tax treatment under the RBC 1 Framework allows insurer to claim tax deduction on the policy liabilities of all insurance funds without the need to make further adjustments so long as the policy liabilities are computed under the RBC basis and in accordance with the Insurance (Valuation and Capital) Regulations.

The above tax treatment for policy liabilities remains the same with the adoption of the RBC 2 Framework as long as the policy liabilities are computed in accordance with the RBC 2 Framework and reported in the insurer's insurance returns submitted to MAS. This means that insurers will be allowed to claim tax deductions on the increase in policy liabilities and any decrease in policy liabilities will be brought to tax in the hands of the insurers without any tax adjustment.

Tax treatment on one-off revaluation of policy liabilities of insurance business arising from the transition from the RBC 1 Framework to the RBC 2 Framework

As the valuation for policy liabilities under the RBC 1 Framework is different from that under the RBC 2 Framework, all insurers would need to perform a one-off revaluation of their policy liabilities when the RBC 2 Framework became effective, i.e. 31 March 2020. Accordingly, this gives rise to a one-off adjustment of policy liabilities for the difference between the carrying amount using valuation rules under the RBC 1 Framework and the re-measured valuation amount based on valuation rules under RBC 2 Framework.

For tax purposes, the one-off adjustment of policy liabilities as mentioned above will be taxed or allowed, depending if the revaluation results in an increase or decrease in policy liabilities. As a result, the one-off adjustment arising from the revaluation of policy liabilities in respect of an insurer's non-participating (non-par) policies, investment-linked (IL) policies, general insurance policies and reinsurance policies will be brought to tax/ allowed a deduction by the IRAS in the year of assessment relating to the basis period in which the RBC 2 Framework took effect.

The above tax treatment does not apply to the transitional adjustment of a participating (par) fund of a life insurance business as the taxation basis of a par fund is based on actual distributions to policyholders and shareholders.

For insurers facing cash flow issues due to the additional tax payable arising from the adoption of the RBC 2 Framework, they may submit a request to the IRAS for longer instalment period and the IRAS will review the request on a case-by-case basis.

Tax treatment on the de-recognition of reinsurance arrangements with foreign head offices

Currently, MAS allows a Singapore Branch office of a

foreign insurer to recognise the reinsurance arrangement with its Head Office. Under this arrangement, the Singapore Branch office recognises lesser policy liabilities due to the ceded risks, pays reinsurance premiums to the foreign insurer and receives reinsurance recovery proceeds and commission income from the foreign insurer. These are taxable or deductible.

However, under the new RBC 2 Framework, MAS may de-recognise the reinsurance arrangements between the Singapore Branch office and its Head Office. MAS will allow a transitional period of 2 years and the de-recognition of reinsurance arrangements with the Head Office will take effect on 1 January 2022. During the transitional period where there is such a reinsurance arrangement allowed by MAS, the tax treatments of the reinsurance premiums, reinsurance recovery proceeds and commission income remains the same.

MAS has clarified that such de-recognition of the reinsurance arrangements is for regulatory purposes and does not prohibit the Singapore Branch insurer from continuing with such an arrangement with its Head Office. Thus, from a regulatory perspective, from 1 January 2022, there will be an increase in the Singapore Branch insurer's policy liabilities and there will be no reinsurance premiums paid to the Head Office by the Singapore Branch insurer as well as no reinsurance recovery proceeds and commission income received from the Head Office.

From 1 January 2022, the tax implications arising from the de-recognition will be more policy liabilities will be allowed as a deduction, but the reinsurance premiums paid will not be allowed a tax deduction. In addition, the reinsurance recovery proceeds and commission income received by the Singapore Branch office insurer will not be taxable.

After the transition period, MAS will still allow a reduction of policy liabilities in certain circumstances, subject to certain safeguards being put in place. In such situations, the tax treatment of the above items will be the same as those for normal reinsurance arrangements recognised for regulatory purposes.

Our comments

The review of the RBC Framework and issuance of the RBC 2 Framework are part of MAS' ongoing review of Framework to ensure they remain relevant. MAS constantly reviews the Framework and consults the relevant stakeholders for feedback to improve it.

The release of the Guidelines provides a timely guidance on the tax treatments for insurers transiting into the RBC 2 Framework, in particular the tax treatment on the one-time tax adjustment required to be made by insurers.

In view that it is mandatory for all insurers to adopt the RBC 2 Framework with effect from 31 March 2020, insurance companies should review the possible tax implications which may arise from the adoption of the new Framework. In addition, the Singapore Branch office of foreign insurers should assess if it should continue the reinsurance arrangement with its Head Office as MAS may de-recognise this arrangement and this will create additional tax implications for the Singapore Branch office.

How we can help

As a committed tax advisor to our clients, we welcome any opportunity to discuss the relevance of the above matters/ case to your business.

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