



Workshop on Life Insurance Product Innovation

Tax Issues

FSIS

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Need to define what is insurance and what is a security – where is the boundary?

- How much insurance risk?
- Effect on taxation – does premium tax apply
- What other guarantees apply?

Choice of approach

- I-E
- I-E+U* , or
- Normal corporate (shs) and income tax(savings phs)

- World wide tend is to the last approach - move from mutual to SH structures

I = Investment income

E = Allowable expenses

U = Mortality profit

Current overview

- Need to separate policyholder returns from sh returns
- Need to deal with 3 situations:
 - Pure risk
 - With profits (similar to mutual situation)
 - Mixed contracts – savings and risk

Sources of revenue

- Shareholder:
 - Fees – acquisition, servicing, investement
 - Insurance charges – life, disability etc
 - Discontinuance profits
- Policyholder
 - Investment returns on fund build up



3 stages of taxation

- When premium paid
- During life of policy
- When benefit received (policy loans?)

Ideal taxation for long term savers

- EET – is neutral and economically efficient
- TEE – seen often in practice – nearly as good
- In practice – TTE, TTT, ETE
- ETE often to help get savings habit going – then TTE – but make sure agents do not capture benefit

Other issues

- Assumed tax rate – which marginal rate for policyholder?
- Reserve build up (charge) for tax purposes – smoothing reserves
- Allowing for reinsurance – PH funds?
- Guaranteed return loadings
- Treatment of acquisition and GM expenses
- Allocation of expenses and investment income
- Timing of capital gains tax v. reserve build up
- Any other sources of income
- Transition – carry forwards
- Paying – ‘on behalf’ if XTX
- Estate tax
- Artificial structures - avoidance

And over-riding tax issues

- Neutrality - consistent between economically equivalent entities (mutual funds, unit linked insurance)
- Efficiency – does not distort investment choices
- Simple – not expensive to apply
- Transparent - limits scope for gaming the system

Shareholder's taxable income

Risk premium

-reinsured risk premium

-risk claims

+reinsurance recoveries

+ investment income on capital and risk reserves

+ s.h.'s share of with profits surplus distributed

+other income

-allocated expenses

+/_ change in risk claims provisions

i.e. similar to non life insurance

Policyholders' income

With profits investment income

+ non participating savings contract investment income

- sh's share of with profits surplus
- with profits allocated expenses
- non par allocated expenses

Treatment of acquisition expenses

- Normally spread for tax purposes
- Some countries only allow part of acquisition expenses (however commission is taxed in agents' hands)

Other taxes

Some countries apply premium taxes –
most often to risk business

International comparisons – Ins. Co. tax

Country	Mortality profit	Investment income	Income allocation	Other taxes
UK	I-E: accounts disregarded	Indexation of CGs. Special rules for IL.	Income allocated: differential tax rates	N/a
Germany	Normal accounts – adjusted: no discounting	Usually taxed	Some allowances to sh fund	N/a
France	Normal accounts - adjusted	Usually taxed. Special rules for IL	PH allocation deductible	N/a
US	Total income less ph dividends	Taxed allowing for investment type	N/a	State premium taxes

International comparisons – Policyholder tax

Country	Premium	Internal roll up	Maturity	Death benefit
UK	No deduction	Taxed in the company	Taxable if non qualifying	Inheritance tax?
Germany	No deduction	Mixed - complex	See previous column	Inheritance tax?
France	Some relief	Tax free roll up	Depends on term	Complex
US	No deduction	Tax free roll up	Yes – on surplus over investment	Not taxed – but estate duty depends on how will structured

Issues with IL funds

- Tax liability provision for unrealized capital gains – internal linked funds
- Treatment of created and cancelled units
- Where life company and UT tax comingled?
- Attribution of tax losses – ensuring equity
- Timing of cash deductions for tax accrual
- Disclosure of tax treatment in policy documents

