LIFE INSURANCE TAX REFORM

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Outline of Discussion

From a tax policy perspective

- **Why** tax on the life insurance business is being reformed
- **How** the reform has taken shape
- **What** is in the reform?
- **Where** the reform may head

Commercial environment

- Life Insurance
  - 36 life insurance companies
  - 6 comprise 90% of industry
- Largely foreign owned NZ subsidiaries
- Many mergers & consolidations
- Annual premiums approx $1.5b
- Annual benefits (maturities and death benefits) $800m +
- $8b funds under management

Current tax regime

Risk business taxed on narrow base

- Designed for traditional savings products
- Risk products generate “tax” losses
- Losses used to offset other group income
- Significant cost to the NZ tax base
- Inconsistent with taxation of similar activities

Typical term insurance income example

Inverse relationship between the accounting income and taxable income per following example:

	Financial accounting	Current tax life base
Premiums	**100**	
Claims	**(50)**	
Investment income	**10**	**10**
Expenses	**(35)**	**(35)**
Premium loading (20% claims)		**10**
Accounting profit/ tax (loss)	**25**	**(15)**

Typical term insurance income example *(cont'd)*

- Greater accounting profit does not necessarily lead to a higher tax liability as would normally be expected for any other taxpayer.
- If another life insurer had the same financial accounting results as above except that Claims were $25, accounting profit would be $50, but the premium loading for tax is $5 and the tax loss is ($20), which is a larger loss than in the first example.

Savings

Problem

- Different tax treatment between investment savings vehicles (including life insurance) & direct investors

Partial Solution (from 2007)

- Life insurers can elect for unit linked products to be included in PIE rules 2008-09 income year (or earlier if elected)
  - Exemption for realised capital gains at LOB
  - Exemption for realised and unrealised capital gains at PHB
  - Deemed disposal and 3 year payment window
- Incorporation of FDR to PHB (corrects technical anomaly)

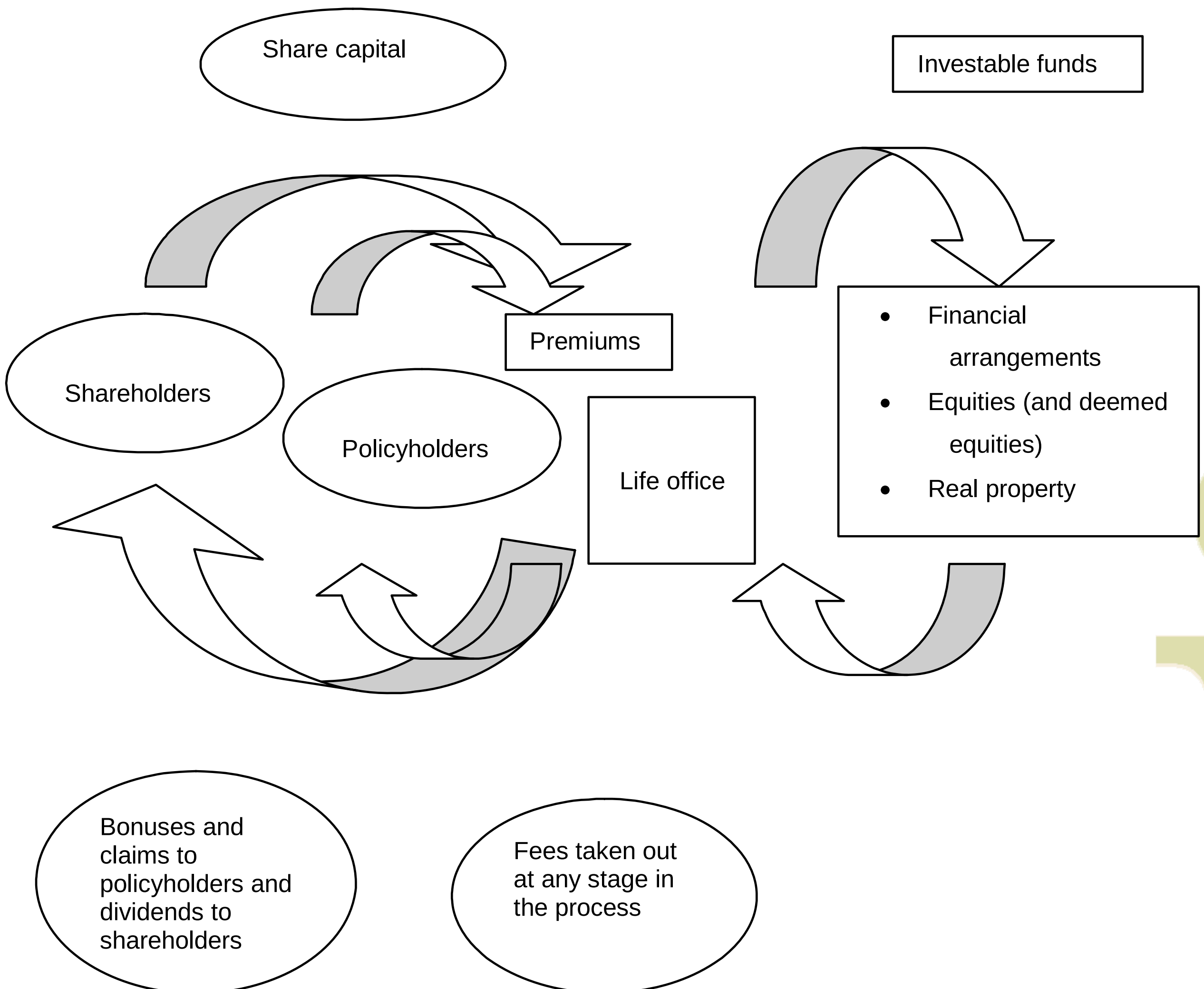
Ideal tax system

The ideal life tax system:

- is transparent;
- integrates as much as possible with actuarial and accounting principles;
- is robust but flexible enough to incorporate new ways of doing business;
- minimises costs of compliance;
- simplifies administration and collection of tax;
- imposes tax in the same way as comparable activities ;
- is equitable between shareholders , policyholders, and the government; and
- reflects commercial reality.

(Life Insurance tax reform- Officials' Paper No 1- Scope of the review (September 2006))

Operations of a life insurance company



Tax reform

- Concerns:
  - Under taxation of risk
  - Over taxation of savings
- Separates risk and fees (life insurer –referred to as shareholder) and savings (policyholder)
- Integrates savings (as much as possible) in PIE rules
- Application date – 2009/2010 tax returns
- Products
  - Risk
  - Unit linked
  - Traditional
  - Annuities (pending)

Shareholder net income

General Insurance model

- Risk net income: premiums & claims excluding savings
- Shareholder share of participating profits
- Reserves adjustments
- Investment income & imputation credits of shareholders
- Fee & other income net of all shareholder expenses
- Reinsurance inside NZ: excluding financial reinsurance

Policyholder net income

PIE model

- Net investment income allocated to policyholders including unit linked policies
- Electing unit linked funds to attribute income to policyholders at PIE rates (cap at 30%)
- Australasian share exclusion to apply to all investment income (including participating)

Transitional relief

- Risk policies sold & “financial reinsurance” entered into before 1 April 2009 taxed under old rules for up to 5 years
- Fixed premium risk policies & annuities & home equity release products taxed under old rules
- All investments deemed sold and repurchased on entry
- Transitional Life Base tax losses allocated to shareholder, or to policyholder to the extent of cancelled transitional Policyholder Base losses
- All imputation credit balances automatically transferred to the shareholder Imputation Credit Account

Issues arising during consultation

- Complexity
- Breakdown between risk, fees, and savings components of premiums and claims
  - Default basis, or
  - More equitable basis
- “Actuarially determined”

Issues arising during consultation

Reserves

- Implications of deducting deferred acquisition costs
- Objective to include appropriate amounts for outstanding claims and claims which have been incurred but not yet reported

Issues arising during consultation

Traditional Business

- No apparent way to attribute income to policyholders
- Timing issues
  - Tax liability on bonuses?
  - Tax claims?
  - Tax income as derived?
- Australasian equity exclusion
- Capital guaranteed products
- I-E?

Issues arising during consultation

Transition

- Fairness for existing policyholders
- Consistency with other tax changes
- Issues to be determined
  - Scope of guarantee
  - Group Life
  - Partial pre-application amendments to existing policies
- IFRS
- Application date

Annuities

- Retirement Commissioner's 2007 report
- Proposed rules provides tax paid amount
- Desire to include annuities in PIE rules
- Relationship with home equity release

Concluding comments

- Where to from here?
- Legislative process
- Interaction with officials