



**Inland Revenue**  
Te Tari Taake

**LIFE INSURANCE TAX REFORM**  
NZ Society of Actuaries Conference  
Wairakei

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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:

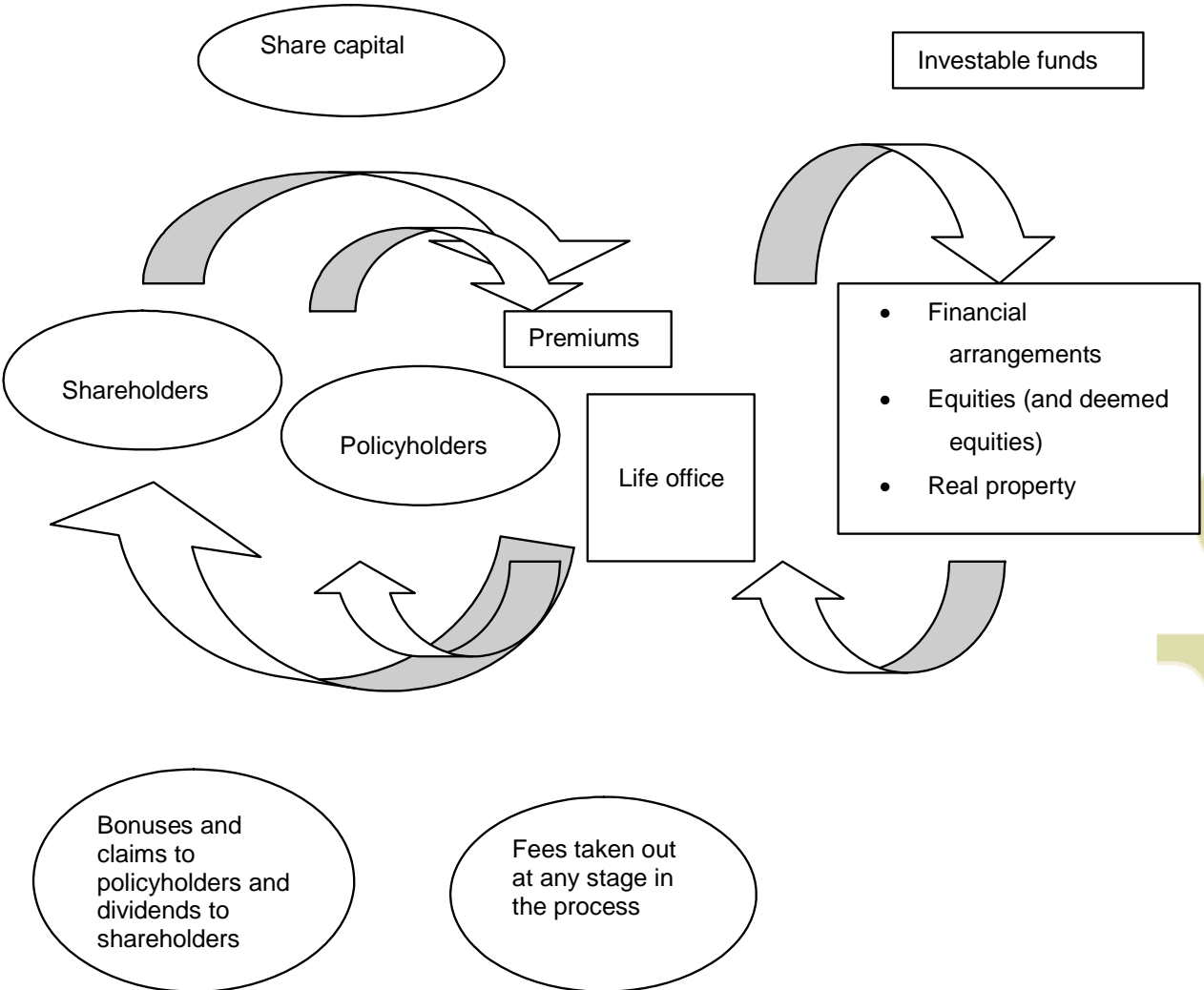
- ❖ is transparent;
- ❖ integrates as much as possible with actuarial and accounting principles;
- ❖ is robust but flexible enough to incorporate new ways of doing business;
- ❖ minimises costs of compliance;
- ❖ simplifies administration and collection of tax;
- ❖ imposes tax in the same way as comparable 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))



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# 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

