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IFRS 17 Discussion Papers

Policyholder Taxes

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Disclaimer
This discussion paper captures views expressed during the IFSR 17 Working Group meetings. The paper is intended to assist in considerations when implementing the IFRS 17 Insurance Contract Standard, each insurer would still need to consider facts and circumstances specific to their contracts in applying the Standard.
Please note that every effort has been made to ensure that the views given in this discussion paper is correct. Nevertheless, that advice is given purely as guidance to members of SAICA to assist them with particular problems relating to the subject matter of the educational material, and SAICA will have no responsibility to any person for any claim of any nature whatsoever that may arise out of, or relate to, the contents of this educational material.

Policyholder taxes

In South Africa, the trustee principle is applied when taxing policyholder income that is accounted for in the applicable policyholder fund of a long-term insurance company. This is on the basis that insurers are deemed to hold and administer certain of their assets on behalf of various categories of policyholders while the balance of their assets represents shareholders' equity.

This income tax system has been designed such that the income tax which is collected from the insurer in respect of the policyholder funds approximates the income tax which would have been collected, had the income tax been levied on the income due to each of the policyholders in their individual capacities.

The question is how such policyholder taxes should be accounted for in terms of IFRS 17.

IFRS 17 states the following:

> "Cash flows within the boundary of an insurance contract are those that relate directly to the fulfilment of the contract, including cash flows for which the entity has discretion over the amount or timing. The cash flows within the boundary include:
>
> (j) payments by the insurer in a fiduciary capacity to meet tax obligations incurred by the policyholder, and related receipts" (IFRS 17.B65).

Before the Amendments to IFRS 17 in 2020, IFRS 17.B66(f) stated that:

> "The following cash flows shall not be included when estimating the cash flows that will arise as the entity fulfils an existing insurance contract:
>
> (f) "Income tax payments and receipts the insurer does not pay or receive in a fiduciary capacity. Such payments and receipts are recognised, measured and presented separately applying IAS 12 Income Taxes".

Tax cash flows would only have been included in the fulfilment cash flows (when measuring an insurance contract) if they were received or paid in a fiduciary capacity. IFRS 17 does not define the term "fiduciary". Some interpret it as "on behalf of".

The concern of the long-term insurers was that insurers incur tax payments, other than in a purely fiduciary capacity, as the insurer fulfils insurance contract services. If the policyholder related tax cashflows were excluded from fulfilment cash flows, as they did not meet the definition of fiduciary tax payments, it would have resulted in an understatement in the measurement of the probability weighted fulfilment cash flows related to policyholder liabilities. Consequently,

the contractual service margin ("CSM") would have been overstated and in some instances could result in onerous contracts being recognised as profitable.[1]

The long-term insurers combined effort and drafted a letter "Tax related to the fulfilment of insurance contract services and IFRS 17 – Insurance Contracts" which SAICA submitted to the IASB on 25 September 2019.

The IASB considered the tax cash flows as part of their deliberations on the IFRS 17 Amendments. As a result, IFRS 17.B66 & B121 were amended as part of the 2020 Amendments as follows:

> "The following cash flows shall not be included when estimating the cash flows that will arise as the entity fulfils an existing insurance contract:
>
> (f) income tax payments and receipts the insurer does not pay or receive in a fiduciary capacity or that are not specifically chargeable to the policyholder under the terms of the contract" (IFRS 17.B66).

> "Paragraph 83 requires the amount of insurance revenue recognised in a period to depict the transfer of promised services at an amount that reflects the consideration to which the entity expects to be entitled in exchange for those services. The total consideration for a group of contracts covers the following amounts:
>
> (ia) amounts related to income tax that are specifically chargeable to the policyholder" (IFRS 17.B121).

Based on the above paragraphs, the income tax payments and receipts are included in the fulfilment cash flows (if they are specifically chargeable to the policyholder under the terms of the contract) as well as the amounts specifically chargeable to the policyholder.

Example:

> The expected policyholders' share of the investment return earned on underlying items is R1 000. The policyholder tax rate is 28%. Charges of R280 will be specifically charged to the policyholders in respect of this investment return.
>
> The company also has R300 of expenses and obtains tax deduction of R84. This tax relief is not credited to the policyholders. The payment to the South African Revenue Services is for the net amount of R196 (R280 – R84).
>
> Should R280 or the R196 be included in the fulfilment cash flows?

[1] https://www.saica.org.za/resources/68711

Staff Paper AP2F discussed at the February 2020 IASB meeting[2], noted that by accepting a charge that is specifically charged to the policyholder under the terms of the contract, the policyholder bears all the risks associated with those costs, and the insurance entity none. No profit would arise for the entity because cash outflows (income tax payments to the tax authority) would always result in equal cash inflows (reimbursement of income tax charged to a policyholder).

Based on the above it seems that R280 should be included in the fulfilment cash flows, i.e. equal to the amount specifically chargeable to the policyholder. It will be included as an inflow as the amount chargeable to the policyholder, but also as an outflow as a tax cash flow. The tax relief of R84 is not passed on to the policyholders and will be reflected in the income tax line item in the income statement of the insurer.

The example may not be applicable to all insurers. Insurers should consider their specific facts and circumstances to determine what amounts are specifically charged to the policyholder.

The interest group considered whether income tax payments and receipts are specifically chargeable to the policyholders and whether this ability to charge is reflected in the terms of the contract. The interest group specifically referred to IFRS 17.2 which states that:

> "An entity shall consider its substantive rights and obligations, whether they arise from a contract, law or regulation, when applying IFRS 17. A contract is an agreement between two or more parties that creates enforceable rights and obligations. Enforceability of the rights and obligations in a contract is a matter of law. Contracts can be written, oral or implied by an entity's customary business practices".

The terms of contract may be seen as the wording in the actual contract with the policyholder. Alternatively, members argued that it can be interpreted wider based on IFRS 17.2 which refers to "contracts can be written, oral or implied by an entity's customary business practices".

2 https://www.ifrs.org/content/dam/ifrs/meetings/2020/february/iasb/ap2f-amendments-to-ifrs.pdf