Bill on taxation of insurers upon implementation of Risk-based Capital regime

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Issue 6

In brief

The Insurance (Amendment) Bill 2023[1] (Bill) was gazetted on 6 April 2023. The Bill seeks to amend the Insurance Ordinance (Cap. 41) (IO) to provide a legal framework for the implementation of a Risk-based Capital (RBC) regime for the Hong Kong SAR insurance industry. It is envisaged that as adopting the RBC regime may potentially create a one-off taxable transitional adjustment to insurers, the Bill seeks to amend the relevant sections of the Inland Revenue Ordinance (IRO) to provide a legal basis for the one-off transitional adjustment to be assessed over a period of five years. The Bill also proposes amendments which could change the taxation basis of certain insurance business.

In this news flash, we summarise the key observations on the proposed amendments to the IRO.

In detail

Ascertainment of assessable profits of insurance companies

Life insurance business

The definition of life insurance business remains unchanged in the Bill, which means the business of any of the following classes specified in Part 2 of Schedule 1 to the IO:

(a) Class A (life and annuity);
(b) Class B (marriage and birth);
(c) Class C (linked long term);
(d) Class E (tontines).

The '5% premium method' for ascertaining the assessable profits of the life insurance business remains unchanged.

Insurers may continue to make an irrevocable election to be taxed under the adjusted surplus method (Adjusted Surplus). The Bill proposes to expand the formula of calculating Adjusted Surplus by adding a specific formula to carve out surplus deemed to be generated from non-life long term business if an insurance fund is to support both life insurance and non-life long term insurance businesses.

Non-life long term insurance business

The Bill defines non-life long term insurance business to mean the business of any of the following classes specified in Part 2 of Schedule 1 to the IO:

(a) Class D (permanent health);
(b) Class F (capital redemption);
(c) Class I (retirement scheme management category III)

The Bill provides that the assessable profits of non-life long term insurance business of insurers are ascertained based on Adjusted Surplus, regardless of the taxation basis for the life insurance business.

General insurance business

General insurance business continues to be assessed under section 23A of the IRO. General Insurance business means a business of a class specified in Part 3 of Schedule 1 to the IO.

Effective date

Subject to the enactment of the Bill, the above amendments will become effective in the year of assessment in which an insurer adopts the RBC regime, whether by early adoption or upon enactment of the amended IO.

Spreading over the one-off impact in assessable profits arising from the implementation of the RBC regime

It is anticipated that certain insurers may recognise a significant reduction in their insurance liabilities in the year they adopt the RBC regime (Specified Amount). Therefore, the Bill proposes to introduce a spreading over arrangement whereby upon an irrevocable election by insurers, the Specified Amount will be assessed evenly over a period of five years commencing from the year of assessment in which the insurers adopt the RBC regime (Material Year of Assessment). The tax treatment of the Specified Amount under such election in respect of different classes of insurance business are summarised as follows:

	Life insurance business and non-life long term insurance business	**General insurance business**
Definition of Material Year of Assessment	(a) The year of assessment within which the date of an insurer early adopts the RBC regime falls; or (b) The year of assessment within which the commencement date of the Bill falls (for insurers which do not early adopt the RBC regime)	The year of assessment within which the commencement date of the Bill falls
Ascertainment of assessable profits	The assessable profits of an insurer from its life insurance business / non-life long term insurance business / general insurance business are ascertained by deducting four-fifths of the Specified Amount for the Material Year of Assessment. In each of the four consecutive years following the Material Year of Assessment, the assessable profits of the insurer are ascertained by adding one-fifth of the Specified Amount. If the insurer ceases to carry on the relevant life insurance business / non-life long term insurance business / general insurance business in Hong Kong at any time in the basis period for any year of assessment (Cessation Year) within the three consecutive years of assessment following its Material Year of Assessment, the remaining portion of the Specified Amount not taxed needs to be added to the assessable profits of the insurer for the Cessation Year.	

New reporting requirements in the tax return

Certain new items have been added in the 2022/23 profits tax return (i.e. items 7.10, 7.10.1 and 7.10.2). They require insurers to indicate whether they adopt the RBC regime in the year of assessment 2022/23, and if yes, the amount of one-off adjustment as well as whether they would elect (subject to the enactment of the Bill) to have the adjustment be spread evenly over a period of five years.

Our observations:

- The taxation basis for life insurance business broadly remains unchanged.
- There is no mention of adopting the profit or loss recognised in accordance with the International Financial Reporting Standard / Hong Kong Financial Reporting Standard 17 *Insurance Contracts* as the basis of taxation for long term business.
- The concept of 'non-life long term business' which will be taxed based on Adjusted Surplus is newly introduced. This category of business is included in 'non-life business' under the existing tax law and taxed under section 23A of the IRO. Accordingly, there will be a change in taxation basis for this new category of business.
- General insurance business is defined in the Bill and taxed under section 23A of the IRO.
- The one-off adjustment due to adoption of the RBC regime may be taxed over five years by making an irrevocable election, and subject to special taxing rule upon cessation of an insurance business within the first three years following the Material Year of Assessment. If no election is made, the Specified Amount (whether gain or loss) would be included in the assessable profit and assessed accordingly.
- The Bill is introduced into the Legislative Council on 19 April 2023 for the First Reading.

The takeaway

We are pleased to see that the Bill has taken into account the industry's request for allowing the Specified Amount to be spread over five years of assessment, greatly alleviating insurers' cash flow pressure.

However, the unexpected amendments will change how the assessable profits of certain insurance businesses are ascertained. This is especially so for non-life long term insurance businesses, which will be assessed using the Adjusted Surplus. This will impact the tax filing basis of insurers that carry on non-life long term insurance businesses currently assessed under section 23A of the IRO.

In view of this, insurers are recommended to seek professional advice in order to plan ahead for the tax filing basis upon adoption of the RBC regime, especially insurers that adopt the RBC regime in year 2022 as the upcoming profits tax filing for the year of assessment 2022/23 may be impacted.

Endnotes

1. The Bill and the Legislative Council Brief on the Bill can be accessed via these links:
   https://www.legco.gov.hk/yr2023/english/bills/b202304062.pdf
   https://www.legco.gov.hk/yr2023/english/brief/ins216c_20230404-e.pdf

Let's talk

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