

LIFE INSURANCE COMPANIES: REINSURED EXPENSES

Finance Bill

1 Expenses: reinsurance commissions

(1) Section 76 of ICTA (expenses of insurance companies) is amended as follows.

(2) In subsection (7), in Step 2, omit “or” at the end of paragraph (b) and insert at the end “or

(d) required to be deducted by subsection (9A) below.”

(3) After subsection (9) insert –

“(9A) The amount required to be deducted at paragraph (d) of Step 2 is the total of the amounts (if any) arrived at under subsection (9B) below in relation to reinsurance arrangements made by the company.

(9B) The amount referred to in subsection (9A) above in relation to any reinsurance arrangement made by the company is that by which –

(a) the relevant reinsurance fraction of so much of the amount found at Step 1 as relates to policies and contracts which are relevant reinsured policies and contracts in relation to the reinsurance arrangement, exceeds

(b) the total amount of any reinsurance commissions under the reinsurance arrangement relating to those policies and contracts on which the company is chargeable to tax for the accounting period under section 85 of the Finance Act 1989.

(9C) For the purposes of subsection (9B) above “the relevant reinsurance fraction” is –

RL/TL

where –

RL is so much of TL as is reinsured under the reinsurance arrangement, and

TL is the amount of the total liabilities under the relevant reinsured policies and contracts at the end of the accounting period.

(9D) For the purposes of subsections (9B) and (9C) above policies and contracts are relevant reinsured policies and contracts in relation to a reinsurance arrangement if –

(a) they are attributable to the company’s basic life assurance and general annuity business, and

(b) any or all of the risks under them are reinsured under the reinsurance arrangement.”

(4) The amendments made by this section have effect in relation to policies and contracts made on or after 8 October 2007.

(5) For the purposes of the operation of Step 6 in section 76(7) of ICTA in relation to an accounting period of an insurance company beginning on or after 9 October 2007, the adjusted amount of the acquisition expenses (within the meaning of section 86(6) of FA 1989) of the company for any earlier accounting period which is relevant for those purposes (a “relevant earlier accounting period”) is to be arrived at as if the amendments made by this section had effect in relation to policies and contracts whenever made.

(6) And for those purposes, if the relevant earlier accounting period is a period which began before 1 April 2004 the amount which would be required to be deducted for that period at paragraph (d) of Step 2 by the subsection (9A) inserted by subsection (3) is to be treated as an amount to be deducted from the amount treated as the expenses of management of the company for that period under section 75 of ICTA as it applied in relation to the relevant earlier accounting period by virtue of section 76 of that Act.

(7) In the application of the subsection (9B) inserted by subsection (3) by virtue of subsection (6) –

- (a) the reference to Step 1 is to be read as a reference to section 75 (as it so applied), and
- (b) the reference to section 85 of FA 1989 is to be read as a reference to section 76(1)(ca) of ICTA (as it applied in relation to the relevant earlier accounting period).

EXPLANATORY NOTE

SUMMARY

1. This clause prevents life insurance companies getting tax relief for expenses relating to reinsurance arrangements where they have not borne the economic cost of those expenses

DETAILS

2. Subsection (1) is introductory, providing for the amendment of section 76 of the Income and Corporation Taxes Act 1988 (ICTA), which contains the provisions allowing relief to a life insurance company for expenses of its basic life assurance and general annuity business (BLAGAB).
3. Subsection (7) of section 76 sets out 8 steps for computing the expenses deduction for an accounting period. Subsection (2) amends Step 2 in subsection (7) to add a new paragraph (paragraph (d)) which provides for a further deduction from the amount of expenses falling within Step 1. This deduction is of the amount specified by the new section 76(9A) ICTA inserted by this clause.
4. Subsection (3) inserts the new subsection (9A), as well as subsections (9B), (9C) and (9D) into section 76.
5. New subsection (9A) provides that the deduction made by paragraph (d) of Step 2 is the total of the amounts, if any, computed in accordance with new subsection (9B), in relation to reinsurance arrangements made by the company.
6. This deduction then feeds through to the calculation of the “adjusted amount” of acquisition expenses in section 86(6) Finance Act (FA) 1989 which is the amount spread over seven years in accordance with that section and section 76(7) Steps 6 and 8.
7. New subsection (9B) defines the amount referred to in subsection (9A) as the excess of
 - the **relevant reinsurance fraction** (a term defined in subsection (9C) – see paragraph 8 below) of so much of the Step 1 amount of expenses (which will in general be

acquisition expenses such as commissions paid to agents) as relates to policies and contracts which are **relevant reinsured policies and contracts in relation to a reinsurance arrangement** (a term defined in subsection (9D) – see paragraph 9 below)

over

- the total amount of any reinsurance commissions under the reinsurance arrangement relating to those policies and contracts which are chargeable under section 85 FA 1989.
8. New subsection (9C) defines the **relevant reinsurance fraction** as RL/TL where
- TL is the total of liabilities under the **relevant reinsurance policies and contracts** at the end of the accounting period
 - RL is so much of TL as is reinsured under the reinsurance arrangement
9. New subsection (9D) defines **relevant reinsured policies and contracts in relation to a reinsurance arrangement** as policies attributable to basic life assurance and general annuity business (BLAGAB) where any or all of the risks are reinsured under the reinsurance arrangements
10. Subsection (4) is the main commencement rule. The amendments to Step 2 apply in relation to policies and contracts entered into by the direct insurer (the cedant under the reinsurance arrangements) on or after 9th October 2007, irrespective of when the relevant accounting period started.
11. Subsections (5) and (6) provide for an adjustment to the amount of the second to seventh “sevenths” of the acquisition expenses otherwise deductible by virtue of section 86(8) FA 1989 and Step 8 of section 76(7) of ICTA. Subsection (5) applies where the “base period” for the purposes of section 86 begins after 31st March 2004 and requires the “adjusted amount” to be recalculated as if section 76(9A) to (9D) applied in that period. But the revision to the amount deductible only applies for accounting periods beginning on or after 9th October 2007. There is no effect on deductions for earlier periods.
12. Subsection (6) provides for a similar adjustment to “sevenths” where the expenses were incurred by the cedant in an accounting period beginning before 1st April 2004. In this case

the terms used in section 76(9B) ICTA that relate to the changes made by FA 2004 are modified, in subsection (7), so as to refer to terms used in the pre-FA 2004 version of sections 75 and 76 ICTA.

13. Example

BLAGAB liabilities total £4000 of which

- £2000 not reinsured
- £1000 reinsured 50% quota share
- £1000 reinsured 100% quota share

BLAGAB expenses total £800, of which

£400 relates to the policies and contracts reinsured under the 50% quota share agreement and

£400 relates to the policies and contracts reinsured under the 100% quota share agreement and

Reinsurance commission received is

- £200 on the 50% quota share arrangement
- £0 on the 100% quota share arrangement

Subsection (9A) amount

1. The 50% quota share arrangement

TL = £1000

RL = £500

So relevant reinsurance fraction (RRF) is $500/1000 = 0.5$

Step 2(d) deduction = $£400 \times 0.5 - £200 = £0$

2. The 100% quota share arrangement

TL = £1000

RL = £1000

So relevant reinsurance fraction (RRF) is $1000/1000 = 1$

Step 2(d) deduction = $£400 \times 1 - 0 = £400$

BACKGROUND NOTE

14. Normally where a life insurance company reinsures any of its business it will receive a “reinsurance commission” or “ceding

commission” payment from the reinsurance company which is designed to cover some or all of the life insurance company’s costs incurred in selling the business which has been reinsured. Under current law, the commission received from the reinsurance company will be offset against the expenses which the life insurance company has incurred in selling the business which has been reinsured, meaning that the life insurance company obtains a tax deduction only for the expenses it has ultimately borne.

15. HM Revenue & Customs has seen examples of arrangements used by life insurance companies in an attempt to obtain full tax relief for all costs incurred in writing business which has been reinsured, even although these costs have been partly or wholly reimbursed by the reinsurance company.