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Asia Pacific Insurance Tax News

PwC's Asia Pacific Insurance Tax News is a periodic publication that offers insights into topical tax issues in the insurance industry in the Asia Pacific region.

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Contents

Editor's say

I am delighted to present to you the fourth edition of our Asia Pacific Insurance Tax News. This year's edition is another bumper issue with 16 articles authored by our specialists from fifteen Asia Pacific countries, including first time contributors Papua New Guinea (PNG) and Vietnam.

Asia is a diverse place. Some countries like Australia, New Zealand, Korea and Japan have matured insurance markets and relatively high insurance penetration rates. Yet others, like Vietnam, Indonesia and PNG are still in the early stages of insurance development. Countries like China and India are only cautiously opening its doors to foreign insurers. All these mean a varying development of regulations and tax rules for insurers.

Across Asia, we continue to see accounting, regulatory and tax reforms. Consolidation is also being encouraged in a number of countries. Overall, global developments such as Solvency II and IFRS (International Financial Reporting Standards) continue to have a strong influence in Asia as most countries move in the direction of "global best practice".

We also see a growing trend of countries seeking ways to raise tax revenues and protect their turf. Examples of this can be found in the US' extra-territorial FATCA initiative and the growing focus of many countries on the issues of transfer pricing and treaty relief. Indirect taxation also throws up a variety of issues in several countries.

Tax rules are not always tailored for the peculiarities of the insurance business. They tend to lag behind the accounting and regulatory developments. In fact, it is not unusual to find tax authorities and tax professionals alike grappling to even understand the nature of insurance business.

As ever before, insurers need to keep abreast of the changing environment, understand its impact on their tax positions and seek to proactively manage their tax risks and challenges.

In this issue of Asia Pacific Insurance Tax News, we will share with you some of these tax developments, changes and challenges. We will also share some opportunities that could be of use to you. I hope you will find our articles useful and interesting.

If you would like to discuss further any of the issues raised, please contact the individual authors or contacts listed after each article, our country leaders listed at the back of this publication or your regular contact at PwC. We look forward to your feedback.

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Asia Pacific
FATCA: Assessing the implications for insurance companies in Asia

In an effort to crack down on tax evasion by US citizens and residents, the United States has enacted new information reporting and tax withholding requirements for non-US financial institutions globally. The Foreign Account Tax Compliance Act (FATCA) requires financial institutions to employ enhanced due diligence procedures to identify US persons who may be using non-US financial accounts or entities to evade US taxes.

Although substantial portions of the law's implementation remain unwritten, the statutory definitions are broad and not only classify insurance companies as financial institutions, but also define certain insurance contracts as financial accounts.

Death of bank secrecy?

FATCA was enacted in March 2010 in response to the perception that US persons are evading US tax requirements by not declaring all of their global sourced income. The US government estimates that this costs billions in lost tax revenues annually. FATCA is an all-encompassing requirement; the ramifications for insurance companies that do not move quickly to understand the implications may be massive come 2013, when the phase-in of FATCA's provisions begins.

Non-compliance can mean a withholding tax of up to 30 percent on payment flows, both gross and profits sourced, and also payments from FATCA-compliant institutions to non-compliant institutions. For most, this means that non-compliance is not an option.

To comply, virtually all foreign financial institutions (FFIs), including insurance companies in Asia, need to adopt procedures designed to identify potential US taxpayers and disclose specific information about them to the US Internal Revenue Service (IRS).

Globally, there also is a broader move by tax authorities to combat tax evasion. For example, Germany and Switzerland recently concluded a treaty to facilitate the identification of undeclared deposits. The United Kingdom has finalised a similar treaty with Switzerland. In the wake of FATCA and these anti-tax evasion efforts by other jurisdictions, one may well argue that the end of bank secrecy and customer privacy rules is near. What is certain is that tax evasion will be far more difficult.

Burdensome requirements

To avoid FATCA's withholding tax, a non-US insurance company must enter into an FFI agreement with the IRS. Under the terms of the agreement, it will need to implement a prescribed process to identify individual policyholders who are US citizens or residents, and, in the case of an FFI that is a policyholder, verify FATCA compliance. For payments made to non-financial foreign entities (NFFEs), the insurance company will need to obtain information about each US owner.

Insurance entities and products in-scope

Whilst the IRS' guidance to-date clearly includes insurance companies within FATCA's ambit, exactly which entities and products fall within its scope remains unclear. However, it is clear that non-US insurance companies must assess the types of information collected from customers to determine whether policyholders are, or are not, US persons, or whether counterparties are FATCA compliant.

The IRS may exclude certain insurance companies – such as those that issue solely non-life insurance – from FATCA, and focus on products with a cash value / investment component, e.g., whole and variable life and annuity products. The IRS views these types of products as having greater risk of being used by US persons to evade US taxes.

Challenges

The IRS' guidance to-date is difficult to apply to insurance companies because it has focused principally on banks and banking products. Because the current guidance is of limited use to insurance companies, in the face of FATCA's tight timeline, they will be forced to adapt quickly as new guidance is issued.

Further, FATCA poses challenges unique to the insurance industry. Often, the only contact an insurer has with its policyholder is at the time of purchase, or when there are policy changes or transactions during the policy's term. To comply with FATCA's requirements, companies are likely to have to change their interactions with their policyholders. Writing new policies may require more documentation, and companies may have to follow up with customers to ensure that all required forms and information is kept current.

In addition, information captured for other purposes, such as on-boarding and AML / KYC, must be reviewed for indicia of US status. More guidance from the IRS is needed here, as compliance with these rules will require fundamental changes to companies' systems and processes.

The clock is ticking

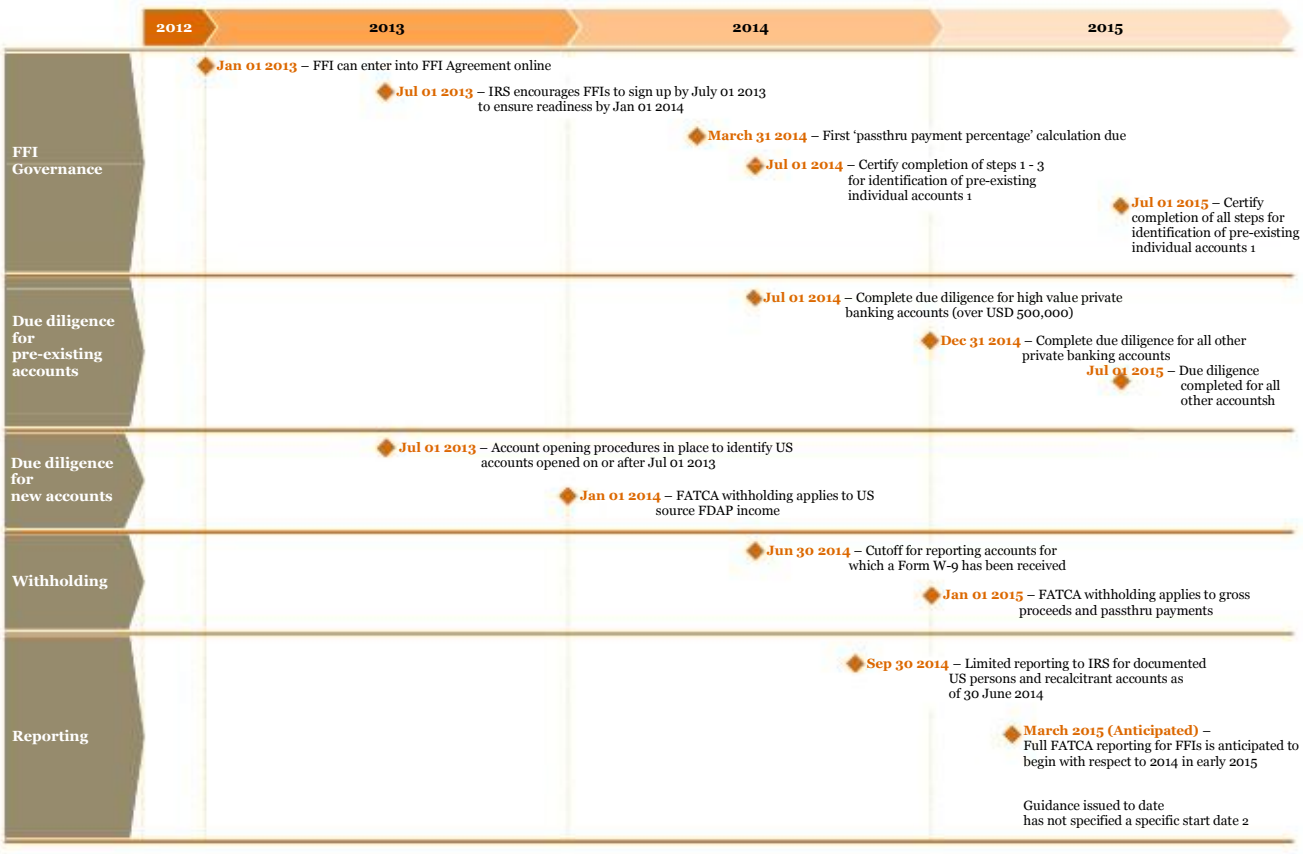
The timeline for implementing FATCA is tight; insurance companies must have entered into an FFI agreement on or before 30 June 2013 in order to avoid being subject to withholding tax on 1 January 2014. Further, by the effective date of the FFI agreement, a participating FFI must have put into place the requisite identification procedures for new policies or accounts.

Faced with FATCA's burdensome requirements, institutions and industry groups have been lobbying Washington to mitigate the legislation's impact. However, the extent to which the US Treasury will bow to this pressure remains unclear.

Whilst the IRS has promised detailed guidance on the implementation of FATCA, it appears that these will not be issued until mid-2012. Despite the lack of clarity, there is no indication from the IRS that the effective dates will be extended beyond those set out in the recently issued Notice 2011-53. This cuts two ways. On one hand, it permits continued lobbying by insurance companies, and other FFIs, to soften FATCA's blow. On the other, it means that insurers will have less time to incorporate the finalised requirements into their businesses.

FATCA has no silver lining; only cost to the business; but the potentially greater costs of non-compliance – on insurance companies and their policyholders – means that most insurers in Asia will need to be compliant, and they should begin planning. For those who already have started to assess the impact, it quickly has become clear that this is not a simple, flick-of-the-switch project, but one that requires a coordinated, group effort.

FATCA Timeline – FFIsA CA ili



1. FFIs must also certify prohibition on advising US accounts on how to avoid detection. Guidance has not been issued specifying the date certifications must be made.
2. Full FATCA reporting includes transactional data, such as interest, dividends and gross proceeds from sale of securities.

Next steps

Some institutions in Asia have questioned the broad reach of the FATCA provisions and are adopting a wait-and-see approach in the hope of additional exceptions, carve-outs or repeal. Others have waited pending the release of regulations by the IRS.

Although many of the details about FATCA's requirements – especially with respect to the insurance industry – remain unclear, there are a number of steps companies can, and should, take now to prepare for FATCA. As FATCA will affect processes and systems enterprise-wide, and will require new and expanded information and reporting systems and procedures, preparing will require a multi-disciplinary effort. Effective and timely FATCA preparation should start with a comprehensive impact assessment that identifies and assesses the following items, based on currently available guidance:

- tax implications on entities and business units;
- business issues affecting key functions and policyholder relationships;
- legal and compliance consequences on current and future contracts; and
- data and operational gaps across people, process and technology.

The time window to make relevant process and technology changes is closing. As companies seek to comply with increased due diligence, verification and reporting requirements for a larger base of customers, they will encounter significant technological and operational issues that may require substantial time and effort to overcome.

Initiating a programme now enables insurance companies to respond strategically and also to reduce the impact on customers. Importantly, a wait-and-see approach may result in an inability to take on new customers come 2013.

The time to begin is now.

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Queries on the application of FATCA in the Asia Pacific region can also be directed to the individual country leaders, whose contact details are listed at the back of this publication.

Australia

Allocation of losses between Australian head office and a New Zealand (NZ) branch

Severe natural catastrophes in the Australia and NZ region during 2010/2011 have resulted in significant losses for Australian insurers and reinsurers. In particular, NZ's recent earthquakes have resulted in very large tax losses that are unlikely to be able to be recouped in the short, medium, or (in some cases) long term. However, arguably, some of these losses should be claimed in other jurisdictions.

For a variety of reasons, including regulatory requirements and costs of capital, many Australian insurers and reinsurers have organised themselves in NZ as a branch of an Australian insurance company.

In some cases, there is a very minimal presence in NZ whereas in other cases the sales, underwriting and risk management functions are all physically located in NZ.

"Depending on the location of where some key functions are, there may be an opportunity to reconsider the allocation of profits and losses between the Australian head office and the NZ branch."

Depending on the location of where some key functions are, there may be an opportunity to reconsider the allocation of profits and losses between the Australian head office and the NZ branch.

This article deals with the question of how branch profits/losses should be allocated to another jurisdiction based on the application of the principles set out in the "OECD Report on the Attribution of Profits to Permanent Establishments - Part IV (the Report)".

In the absence of specific legislation in Australia regarding the allocation of profits between a branch and its Australian head office, the guidance provided in the Report is likely to be applied for Australian income tax purposes. The Australian Taxation Office (ATO) has previously verbally advised that the principles within the Report are largely consistent with the approach adopted in Australia.

How does the Report attribute profits/losses to branches?

The OECD's approach is based on the premise that it is necessary to determine the profits that the branch might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions.

The Report adopts a functional and factual analysis to identify the most important risks for the particular taxpayer, and which functions give rise to those risks. Of particular importance will be the determination of the key entrepreneurial risk-taking (KERT) functions of the enterprise and the extent to which the branch undertakes those functions.

Generally, a KERT function is one which requires active decision-making with regard to the assumption and/or management (subsequent to the transfer) of the individual risks and portfolios of risks that have been identified as the most important under the functional and factual analysis.

What are the KERT functions of an insurance company?

The Report suggests that the assumption of insurance risk (or underwriting risk) is the only KERT function for an insurance enterprise. The management of that risk subsequent to its assumption generally would not involve the kind of active decision making that justifies treating the management function as a KERT function.

Underwriting/Insurance Risk is described in the Report as including a number of activities:

- Setting the underwriting policy;
- Risk classification and selection;
- Pricing;
- Risk retention analysis; and
- Acceptance of insured risk.

The Report considers that the KERT functions will determine the location of the insurance risk and the associated premiums, reserves and surpluses, as well as the investment income derived from the investment assets supporting these insurance risks.

Example

Australian Insurance Company (AIC), an Australian resident insurance company writes an insurance policy against the loss of property with a NZ resident. The insurance agreement is entered into by an Australian underwriter, however the sales, product development and claims management is handled by various employees in the NZ branch.

In this example, it may be argued that the KERT function is in Australia and hence the profits and losses should be attributed to the Australian head office rather than the branch, with the reward to the branch reflecting an arm's length compensation for the functions that the branch performs. Where large losses have been incurred by AIC in relation to NZ, allocation of tax losses to the Australian head office instead of the NZ branch may result in the ability to utilise the losses, if not immediately then at least earlier than they might be able to be used in NZ.

Questions you should be asking yourself

- Do you have a NZ branch?
- How are profits and losses currently being attributed to the branch?
- Is this in line with the position expressed by the OECD in the Report?

Conclusion

This article is intended to provide a general overview of the guidance provided in the "OECD Report on the Attribution of Profits to Permanent Establishments - Part IV" and therefore, should not be relied upon without seeking specific advice. While this article focuses on the allocation of profits or losses to the NZ branch of an Australian insurance company, these principles might also apply in other jurisdictions.

Further investigations should be conducted to confirm whether branch profits/losses should be allocated to another jurisdiction based on the application of the Report. In addition, tax advice on the application of the principles to your particular circumstances should be obtained.

"The Report considers that the KERT functions will determine the location of the insurance risk and the associated premiums, reserves and surpluses, as well as the investment income derived from the investment assets supporting these insurance risks."

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China
Challenges ahead for foreign insurers

Foreign insurers in China continue to fight hard to define their role in the Chinese market, expand their operations, gain traction and increase their market share. While China remains an under-insured market with huge upside potential, the regulatory and tax environment continues to be challenging for the foreign insurers in China. This article highlights some of the latest developments in the China tax regimes that may affect foreign insurers operating in this fast-growing market.

Taxation administration of large businesses

China's tailored approach to the tax administration of Large Business Enterprises (LBEs) is still in an early stage of development. Two years ago, the PRC State Administration of Taxation (SAT) established a Large Business Tax Department and shortlisted 45 large business enterprises (including domestic enterprises and multi national corporations) at a national level to be directly managed by SAT. These enterprises are subject to customised tax administration which is considered to be more appropriate given the scale and complexity of the operations of these taxpayers.

Amongst the national LBEs shortlisted by SAT are a number of financial services groups. Meanwhile, local tax authorities in different cities and provinces have echoed SAT's LBE tax administration initiatives. As a result, they have started to identify LBEs with operations within their geographic remit for customised tax administration.

Foreign insurers in China generally manage a large investment portfolio with complicated operations covering multiple locations. These insurers have not historically contributed significantly to local tax revenues because of their significant losses incurred in the early stages of operation. They are vulnerable to be selected as LBEs by local tax authorities, which could then mean more scrutiny and a more stringent approach to tax administration.

"If an insurer in China were to be selected as a LBE, the tax authorities will generally perform robust tax risk management assessments on the insurer and its operations."

If an insurer in China were to be selected as a LBE, the tax authorities will generally perform robust tax risk management assessments on the insurer and its operations. If the tax authorities conclude that the insurer has failed to establish effective internal tax risk control systems, they may classify the insurer as having a high tax management risk. Thereafter more stringent tax administration is likely to be enforced, including more frequent tax audits on the insurer to ensure the insurer's proper tax compliance.

Insurers anticipating that they may be selected as an LBE may need to strengthen their internal tax risk control systems, in particular, on the following aspects:

- Effective tax planning with commercial justification;
- Thorough consideration of tax factors in their daily operations;
- Accurate tax computations;
- Timely and complete tax filings; and
- Proper maintenance of tax records and documents.

In addition, insurers should also observe the following SAT Guidelines as the benchmark in assessing their existing tax risk management function effectiveness and take actions to improve it if necessary.

- Guidelines on Tax Risk Management of Large Business Enterprises issued on May 2009
- Circular Guoshuifa [2011] No.71 (Circular 71) on "Measures of Taxation Service and Administration for Directly Managed Large Business Enterprises (Trial)" issued on 13 July 2011.

Uncertain business tax treatment of bond Interest

Insurers in China have become increasingly active in the domestic bond (RMB bond) market. This includes the investment and trading of government bonds, corporate bonds and financial institution bonds, etc. Different insurers adopt different investment strategies for these instruments. For instance, some foreign insurers will only hold these bonds to maturity whereas others may trade these bonds actively in the market.

Likewise, as the business tax rules governing interest derived from RMB bonds is unclear, different insurers have taken different business tax filing positions on bond interest.

Over the last couple of years, it was an administrative practice of various local tax authorities not to enforce the 5% business tax collection on bond interest earned by insurers in China. However, the technical position to justify business tax exemption on bond interest has not been well developed. Although a number of local tax bureaus have issued local rulings to exempt business tax on bond interest in the past, some tax officers have taken a narrow view that these favourable local tax rulings were outdated or superseded by other more recent tax rulings.

Another interpretation taken by some tax officers is that business tax exemption on bond interest should only be limited to those bonds that are held to maturity. These officers tend to argue that accrued interest on bonds disposed of before maturity should not be exempted for business tax.

During the course of 2010, extensive tax audit and self-tax-inspection exercises were carried out in the financial services sector in China. Some financial service groups have reached a compromise with local tax authorities to pay back business tax retrospectively on bond interest for early settlement of the tax audit or self-inspection exercise.

Foreign insurers that intend to continue adopting a favourable business tax position on bond interest should closely monitor the future developments on this subject. Hopefully, the SAT will issue more guidelines in future to clarify this uncertain tax position.

Tax Incentive for IT investments

Foreign non-life insurers that have undergone the local incorporation exercise may have found it necessary to put their core information technology (IT) operating system in China. Other foreign life insurers who are striving to provide better levels of customer service may set up local call centres and online customer services platforms. In both instances, this would involve bringing in large computer systems into China as well as expanding or constructing local data centres to host the additional hardware and software. As a result, one of the biggest challenges faced by foreign insurers in China is how to control the upcoming huge IT spending arising from both regulatory and business needs.

One way to achieve cost reduction on IT projects is by way of claiming tax incentives on IT spending. Qualifying expenditure on IT projects in the insurance sector, such as the building of on-line customer services or data warehousing technology platforms, can be allowed as R&D expenses that attract an enhanced tax deduction of 150%. For example, a qualifying IT spending of RMB100 can yield a corporate income tax deduction of RMB150. Essentially, this enhanced deduction generates an additional cash tax benefit of RMB12.50 (RMB100 x 50% x 25% tax rate) for every RMB100 of qualifying IT expenditure.

The way ahead

The commitment of foreign insurers to China remains strong as they continue to view China as a strong growth opportunity in global terms. However, there are a wide variety of upcoming tax challenges faced by the foreign insurers in China. As the Chinese tax authorities gradually become more sophisticated in their tax audit approach and more aggressive in their enforcement activities, the need for early preparation cannot be overstated.

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Hong Kong Taxation of Renminbi investments

Due to the growing popularity of Renminbi (RMB) investments, insurance companies in Hong Kong have started to offer RMB insurance products in the last 18 months. To hedge the future payments of RMB policies, insurance companies may invest their premiums in RMB denominated investments and/or investments closely linked to the performance of the RMB. For example, insurance companies have been investing RMB premiums in RMB deposits and RMB bonds, and Hong Kong dollar premiums in investment products issued by Qualified Foreign Institutional Investors (QFII). When the Mini-QFII products[1] are launched in the coming future, insurance companies will have another investment alternative for their RMB premiums.

This article discusses the general taxation treatments of investment income from various types of RMB investments, and highlights some recent Hong Kong tax developments relevant to the taxation of the investment income of insurance companies.

General taxation principles

Broadly, Hong Kong operates under a territorial tax system and only Hong Kong sourced income derived from a trade or business carried on in Hong Kong is subject to Hong Kong profits tax. The "source" of investment income will depend on the nature of the income (e.g. interest or gain on disposal) and the transactions giving rise to such income.

Notwithstanding this, the question of the source of investment income will generally be only relevant for those insurance companies which carry on non-life businesses including life companies which also carry on non-life insurance business (such as Class D permanent health business and Class I retirement scheme management category III business).

Investment income attributable to the life business of an insurer which elects to compute its assessable profits based on 5% of net written premiums is not separately taxable.

Interest income from RMB deposits and RMB bonds

There are certain specific tax exemptions for investment income.

Pursuant to the Exemption from Profits Tax (Interest Income) Order 1998 ("Interest Income Exemption Order"), interest income derived by a non-financial institution from deposits placed with, and certificates of deposits issued by, authorised institutions in Hong Kong are exempt from Hong Kong profits tax where such deposits were not used to secure or guarantee bank borrowings generating deductible interest expenses. Hence, interest income earned by insurance companies (which are not regarded as financial institutions for Hong Kong tax purposes) from RMB deposits placed with Hong Kong authorised institutions would generally fall within the Interest Income Exemption Order. In addition, interest income arising from RMB bonds issued by Hong Kong authorised institutions would also be tax exempt if the bonds fall within the definition of certificates of deposit.

> "Hence, interest income earned by insurance companies (which are not regarded as financial institutions for Hong Kong tax purposes) from RMB deposits placed with Hong Kong authorised institutions would generally fall within the Interest Income Exemption Order."

Another specific tax exemption is pursuant to the Exemption of Profits Tax (Renminbi Sovereign Bonds) Order, whereby interest income derived from, and gain on disposal of, RMB denominated bonds issued in Hong Kong by the PRC Government is specifically exempt from Hong Kong profits tax.

As for other RMB denominated bonds that are not specially exempted (as discussed above), their taxability would depend on the source of such interest income.

Interest income, earned by persons other than financial institutions or money lenders, is generally sourced where the underlying funds are first made available to the borrower.

[1] Mini-QFII products refer to RMB denominated QFII products. Based on investment released in detailed regulations on Mini-QFII are yet to any information, PRC entities China schemes. allowed Securities to Regulatory use Commission offshore has RMB not for

This is commonly known as the "provision of credit" test. Under the "provision of credit" test, where an issuer issued a bond outside Hong Kong and first received the bond subscription monies outside Hong Kong, the interest income derived from the bond would be regarded as having an offshore source and being non-taxable. This applies even if the bond is acquired through the secondary market in Hong Kong.

Whilst most insurance companies in Hong Kong have been consistently adopting the "provision of credit" test in determining the source of their interest income, the Hong Kong Inland Revenue Department (IRD) has, in some recent occasions, sought to take the view that investment activities form part and parcel of an insurance business and therefore the "operation" test, rather than the "provision of credit" test should be used to determine the source of interest income of insurance companies.

Under the "operation" test, one has to look at what the taxpayer has done to earn the profits in question and where these activities are performed in order to determine the source of the profits. It follows that if an insurance company carries on its investment activities in Hong Kong, the interest income derived by the insurance company from the RMB bonds would have a Hong Kong source and become taxable, even though the bonds are issued by non-Hong Kong resident issuers outside Hong Kong.

It should, nevertheless, be noted that the above view of the IRD is highly debatable and has not been tested in court.

Investments in QFII and Mini-QFII

Although the performance of QFII products are linked to the performance of underlying securities in the domestic PRC markets (e.g. A shares), such QFII products, which are usually in the form of participatory notes or swaps, would be treated as separate financial instruments for Hong Kong profits tax purposes, rather than direct investments in the underlying securities.

Accordingly, the source of investment returns from QFII products will depend on the legal form of the products, the locations where the purchase and sale of the products are negotiated and concluded, and the locations where the funds are provided to the issuers of the QFII products (as the case may be). For instance, if the QFII product is in the form of a total return swap and the insurance company negotiates and concludes the entering into of the swap with the QFII in Hong Kong, the investment return from the swap would be regarded as Hong Kong sourced and subject to Hong Kong profits tax.

The structures of Mini-QFIIs are not yet known. Nevertheless, the taxation treatments of Mini-QFIIs are believed to be similar to those of QFIIs.

Realised gain / loss on RMB investments

The source of gains realised on the disposal of RMB products (e.g. RMB bonds) will generally depend on the location where the contracts of purchase and sale of the products are negotiated and concluded.

Where the purchase and/or sale of the RMB bonds are negotiated and concluded by the insurance companies (or their investment managers) off-exchange in Hong Kong, such gains will be regarded as having a Hong Kong source. On the contrary, where both the purchase and sale of the RMB bonds are negotiated and concluded off-exchange by the insurance company outside Hong Kong through a discretionary investment manager, the disposal gain will be regarded as having an offshore source and non-taxable.

"The structures of Mini-QFIIs are not yet known. Nevertheless, the taxation treatments of Mini-QFIIs are believed to be similar to those of QFIIs."

Unrealised gain /loss on RMB investments

Since the decision of the Court of Final Appeal in the case of Commissioner of Inland Revenue v Secan Limited & Ranon Limited, it has been the practice of the IRD to follow the accounting treatment and tax unrealised gains and allow deduction of unrealised losses arising from fair value adjustments of investments at the time when such gains or losses are recognised in the profit and loss account.

However, the judgement in Nice Cheer Investment Ltd v CIR handed down by the Court of First Instance (CFI) on 28 June 2011 held that unrealised gains arising from the revaluation of the taxpayer's trading securities are not taxable at the time such gains are recognised in the profit and loss account whereas any such unrealised losses are tax deductible at the time of recognition. The CFI's judgment was made on the basis that such unrealised gains are not "real profits earned by the taxpayer from trading" within the meaning of section 14 (i.e. general charging section) of the Inland Revenue Ordinance (IRO) whereas there is no similar qualification regarding losses in the IRO.

The IRD has lodged an appeal against the CFI's judgment to the Court of Appeal, the hearing of which is scheduled to be held in May 2012.

In this regard, the Nice Cheer case has cast some doubt for insurance companies, which have been treating unrealised investment gains or losses as taxable or deductible, as to whether they should change the taxation treatment of their unrealised gains on investments. Of course, to adopt such tax position, insurance companies should have proper internal records and/or management information system to keep track of the movement of the fair value of each investment from acquisition to disposal or redemption.

Conclusion

Given the huge demand for RMB investment products, it is believed that more and more new and innovative products will enter the market soon. The above comments on tax treatments of RMB investment products are only general in nature. The tax implications of any particular investment should be carefully evaluated, taking into consideration its form, structure and all other features, as well as the current tax filing position of the relevant insurance company.

"In this regard, the Nice Cheer case has cast some doubt for insurance companies, which have been treating unrealised investment gains or losses as taxable or deductible, as to whether they should change the taxation treatment of their unrealised gains on investments."

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India

GST: The point of taxation rules pack a wallop for life insurers

Unlike many other jurisdictions, India does not currently have a comprehensive value added tax (VAT) which applies uniformly to the provision of both goods and services. At present, differing State-administered VAT regimes impose indirect taxation on the supply of moveable goods within the various States. This patchwork of discrete VAT regimes sits alongside a centrally administered Service Tax which is created under the Finance Act, 1994. Service Tax at an effective rate of 10.30%[1] is levied on over 110 specified taxable services.

The various VAT systems and the Service Tax are shortly to be combined into a comprehensive Goods and Services Tax (GST). As part of the transitioning to this new legislative framework, rules have been promulgated which specify the time at which a taxable supply is taken to have been made by an enterprise. The purpose of this article is to consider the potential impact of these rules on life insurance companies operating in India, and to identify those areas of lingering uncertainty.

Point of taxation

The concept of levy, collection and payment of tax are fundamental aspects of any fiscal law. In the case of Service Tax, the payment of this tax has historically always been linked to the receipt of a service fee. Tax is payable by a service provider on a cash basis except in circumstances where services are supplied to associated enterprises. This approach is not consistent with the equivalent timing rules applicable in the administration of the central excise (applicable on the manufacture of certain goods) and the VAT.

> "Since all Indian indirect taxes are proposed to be brought under the umbrella of the GST, it is now necessary for a common timing rule to apply."

Since all Indian indirect taxes are proposed to be brought under the umbrella of the GST, it is now necessary for a common timing rule to apply. The Point of Taxation Rules, 2011 (the Rules) have been introduced into the machinery provisions of the Service Tax as a harmonising measure. The Rules have shifted the point of taxation to what is effectively an accruals basis. The Rules are still in a nascent stage and there is considerable lack of awareness about their principles and ramifications. Since their introduction in April 2011, clarifications and notifications amending the Rules have already been issued twice owing to the complexity of their application to various industries.

With the introduction of the Rules, the liability to pay Service Tax has shifted from the point when consideration is received for taxable services to the time at which a service is provided, an

[1] The existing rate of Service Tax is 10%, but this is increased by 1% (calculated on the Tax secondary education cess of 2% and higher education cess of 1% collected).

invoice is raised, or an advance is received, whichever is earlier. The Rules define the "point of taxation" to mean the point in time when a service shall be deemed to have been provided. The movement of Service Tax collection to an effective accruals basis has already led to considerable liquidity and working capital problems for service providers, in addition to write-off issues.

"Since an amount has been received in advance, there is some uncertainty as to the point of taxation. It is not clear whether it should be the time that the application money is received or the date the insurance contract is issued."

Life insurance service

It is self evident that life insurance services provided to policyholders are normally for a period of more than a year. These services are provided during the period of the contract and are considered as a continuous supply of services under the Rules. In the case of a continuous supply, the due dates of payment specified in the contract of service determines the point of taxation (except where payment is received or an invoice is raised before the specified due date).

For life insurance products, the usual practise in India is that a sum of money/first premium is paid by the prospective policyholder together with the application. Typically an insurance company will verify the details of an applicant, and after completion of all the required formalities, the insurance contract is issued to the policyholder. Since an amount has been received in advance, there is some uncertainty as to the point of taxation. It is not clear whether it should be the time that the application money is received or the date the insurance contract is issued.

In the case of subsequent premiums, it is common practise for a life insurance company to send a notification letter to policyholders 30 days in advance indicating the due date for payment. A receipt is then issued upon payment of the premium being made. It is an open question whether an insurance company should consider the notification letter sent to the policyholders as the equivalent of an invoice and therefore the applicable point of taxation, or whether the payment of the premium is the appropriate taxing point.

The Insurance Regulatory and Development Authority (the regulatory body for the insurance and reinsurance business in India) has indicated that life insurance companies should give 30 days' grace period to policyholders to make their premium payments. This further complicates the task of determining the point of taxation. It is arguable that this may in fact be the last day of the grace period (30 days after the due date) and not the due date mentioned in the notification letter.

Insurance auxiliary services

Insurers, as service receivers, are liable to pay Service Tax on commissions payable for the marketing and distribution services provided to them by the insurance agents. Where a recipient is obligated to pay Service Tax, the point of taxation prescribed by the Rules is the date of making the payment. However, if payment is not made within 6 months from the specified due date, then the point of taxation is determined from the perspective of the service provider.

It is typical for an insurance company to compute on a periodic basis the amount of commission to be paid to insurance agents. The negotiation and debate over the amount of agency commissions to be paid may however stretch over many months. Consequently, the requirement for Service Tax to be paid within 6 months from the original due date of the commission may not be met. In such circumstances, the insurance companies will have to pay Service Tax along with interest for the appropriate period at the rate of 18% per annum.

Furthermore, in accordance with guidelines issued by the Association of Mutual Funds in India, insurance agents shall not be entitled to receive commission/brokerage in the absence of a registration number. The alternative is for self certification documents to be provided if the insurance agent is not registered with the insurance company. In this latter scenario, there is no pre-existing contract of service between the insurance agent and the insurance company prior to the request for payment of commission. It becomes difficult to ascertain the point of taxation when the application is processed without a broker code, and the brokerage is subsequently paid when the requirements are met.

Though acting in good faith, there is a risk that insurers may get tied up in tax proceedings for delay in the payment of Service Tax.

Conclusion

The Rules have signalled a paradigm shift in the taxation of services across industries that require significant changes in accounting systems, invoicing, and MIS (mangement information systems) reporting to name a few examples. While the Rules are regarded as a major stepping stone towards the approaching GST regime, the puzzling complexities faced by the insurers, unless resolved, are likely to continue. Further, the Rules are silent on various matters such as bad debts, taxation of deposits, self adjustment/refund etc. It is necessary for these issued to be addressed in a timely manner to ensure a smooth sailing towards the proposed GST.

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Indonesia

Transfer pricing and treaty relief updates for the insurance industry

Indonesia has often been cited as having one of the most challenging tax environments for foreign insurers and reinsurers to operate in. In recent years, transfer pricing rules and treaty relief procedures have been particularly taxing. In this article, we will discuss the latest developments in both these areas.

Transfer pricing documentation

It has been almost four years since the Indonesian Tax Office (ITO) initially required taxpayers to have transfer pricing documentation in place. Back in early 2010, the ITO introduced a special form to be attached to the 2009 annual corporate tax return. This form listed the type of transfer pricing documentation that needs to be maintained by taxpayers entering into transactions with related parties. Somewhat surprisingly, there was no indication of the expectations of the ITO on the contents or level of information required in these documents.

In late 2010, the ITO issued the first specific guidance for transfer pricing documentation. Significant portions of the regulation are based on the Organisation for Economic Cooperation and Development (OECD) Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (the OECD Guidelines). These guidelines essentially require that a taxpayer's documentation must demonstrate that its transactions with related parties are consistent with the arm's length principle and with ordinary business practice.

The ITO has the authority to re-determine the amount of related party income and expenses in calculating the taxable income of a taxpayer. The ITO's adjustments may be based on the taxpayer's own transfer pricing method and documentation. Where the taxpayer's documentation is considered to be insufficient, the ITO will conduct its own analysis to re-determine the related party income and/or expense amounts.

The regulation does not discuss how frequently taxpayers should update their transfer pricing documentation, but revisiting transfer pricing documentation annually would be advisable.

Transfer pricing benchmarking

The ITO has in recent times started publishing benchmarking ratios for certain industries. It has provided benchmarks for non-life insurers but has not as yet published an equivalent set of reference numbers for life insurers. It is expected that these may be issued at a later stage.

The benchmarking is a supporting tool used by the ITO in assessing taxpayers' tax compliance. The benchmarks are likely to have an influence on the ITO's assessment of whether or not the related party transactions of a taxpayer have been conducted at arm's length and cannot be used directly as the basis for issuing a transfer pricing assessment alone.

The benchmarking ratios issued for non-life insurers are as follows:

Ratio					FY05	FY06	FY07
Gross	Profit	Margin	(GPM)		45,57%	45,57%	45,57%
Operating	Income	Margin	(OPM)		16,96%	16,96%	16,96%
Pretax	Profit	Margin	(PPM)		25,56%	25,56%	25,56%
Corporate	Tax	to	Turnover	Ratio	7,76%	7,76%	7,76%
	(CTTOR)						
Net	Profit	Margin			17,80%	17,80%	17,80%
	(NPM)						
Dividend	Payout	Ratio	(DPR)		27,58%	27,58%	27,58%
VAT	Ratio	(pn)			0,00%	0,00%	0,00%
Salary	Expense	per	Sales	Ratio	14,69%	14,69%	14,69%
	(g)						
Depreciation		Expense	per	Sales	2,43%	2,43%	2,43%
	Ratio	(py)					
Rental	Expense	per	Sales	Ratio	2,94%	2,94%	2,94%
	(s)						
Interest	Expense	per	Sales	Ratio	0,00%	0,00%	0,00%
	(b)						
Other	Income	per	Sales		8,67%	8,67%	8,67%
	Ratio	(pl)					
Other	Expense	per	Sales	Ratio	0,06%	0,06%	0,06%
	(bl)						
Other	Operating	Expense	per	Sales	22,53%	22,53%	22,53%
	Ratio	(x)					
Inventories	Discrepency		(sp)		0,00%	0,00%	0,00%

Tax treaty relief for holding companies

There has been a lot of controversy in recent times about the beneficial ownership tests, or the so-called "six tests" which are needed to be satisfied in order for a taxpayer to claim treaty benefits. These tests are prescribed in regulations which became effective on 1 January 2010.

Despite some difficulties in their administration, generally, the six tests are in line with accepted principles of beneficial ownership set out in OECD Guidelines. Two years since their introduction, satisfaction of these tests does however remain an issue for some taxpayers. This is especially true for those taxpayers which have been established to act as a passive holding company for an Indonesian subsidiary.

Among the six tests, the following would be the most challenging ones to satisfy for a holding company:

"Despite some difficulties in their administration, generally, the six tests are in line with accepted principles of beneficial ownership set out in OECD Guidelines. Two years since their introduction, satisfaction of these tests does however remain an issue for some taxpayers."

Sufficient qualified employees

The tax definition of 'employee' is unclear. For example, it does not define whether the directors can be considered as employees or how many employees are needed to meet the criteria of sufficient qualified employees. Some holding companies do not even have any employees and it is therefore difficult for these companies to pass this particular test.

Active business

Active business is interpreted as activities "actively carried out by the offshore company as evidenced by the expenses incurred, efforts that have been spent, or sacrifices that have been made which directly relate to the business or activities to obtain, collect, and maintain the revenue." Some holding companies, particularly intermediate holding companies, may not have enough activities or expenses which makes satisfaction of this test difficult.

50% rule

A company cannot use more than 50% of its total income to satisfy claims by other parties in the form of interest, royalties or other fees (excluding salaries paid to employees, other expenses normally incurred by the foreign taxpayer in running the business, and dividend distributions to shareholders). Satisfaction of the 50% test is viewed by the ITO as demonstrating that the income of an offshore company is not simply 'passing through'. This may be problematic in a double-decker holding company structure where subsidiary profits are being passed on to the upper level holding company.

Certificate of Domicile - practical and administrative issues

We set out below some practical and administrative issues that have been encountered in the process of furnishing a Certificate of Domicile (CoD) to the ITO for treaty benefit purposes.

Reinsurance payments through brokers

In the past, some insurance companies that pay offshore reinsurance premiums through offshore brokers relied on a brokers' CoD to obtain an exemption from withholding tax. Such payments were treated as being exempt if they were characterised as service income of the recipient broker and not reinsurance premiums.

This is now not sustainable as the amount and type of income for which treaty relief is sought must now be disclosed on the new CoD form (i.e. DGT Form 1). Therefore, the CoD must be provided for both the broker and the reinsurer. The withholding tax exemption of the reinsurance premium payment must also be assessed individually based on the domicile of the reinsurer. Although most tax treaties with Indonesia exempt the withholding tax on reinsurance premiums, some treaty countries and non-treaty countries may still have withholding tax imposed on them.

Use of standard tax residency certificate issued by a foreign tax authority

The current tax regulations provide that for a non-Indonesian tax resident who is unable to provide a certified DGT Form (say, due to an administrative issue of the foreign competent tax authority), a standard tax residency certificate issued by the foreign competent tax authority can be used to satisfy the CoD certification requirement as required on page 1.

"If the CoD or residency certificate provided is not considered valid by the ITO, there is a risk that 20% withholding tax will be imposed instead of a reduced tax treaty rate."

Specifically for US residents, Form 6166 is allowed to be used for page 1 of the DGT Form. The DGT Form page 2 is still required to be completed.

Questions have been asked on whether an offshore entity may provide tax residency evidence in a form that is not issued by a competent tax authority. We believe that this is unlikely to be accepted by the ITO. If the CoD or residency certificate provided is not considered valid by the ITO, there is a risk that 20% withholding tax will be imposed instead of a reduced tax treaty rate.

Tax audit experience on claiming treaty relief
Up to now, we are not aware of any disputes arising from the completion of the new CoD forms. However, considering that most of the tax audits for the 2010 fiscal year have not yet been finalised (generally 2010 tax audit deadline is April 2012), it is not possible to conclude that issues will not arise in the future.

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Japan
2011 Japan tax reforms

On 25 January 2011 a draft bill for the 2011 tax reform (Draft Bill) was submitted to the Diet. After the Tohoku Earthquake, the discussion on the Draft Bill was suspended. A part of the Draft Bill was approved on 22 June 2011 and become effective on 30 June 2011 (the June Bill).

The following topics, which are the amendments in the June Bill, may affect the insurance industry in Japan. It is expected that discussion will continue on the remaining parts of the original Draft Bill which are not part of the June Bill. This includes the proposed reduction in the corporate tax rate.

Corporate taxation

Group taxation
The group taxation regime introduced by the 2010 Tax Reform was amended. These changes may be summarised as follows:

(1) When a corporation which is a member of a 100% group is in the process of liquidation, is expected to be dissolved (by other than merger), or is expected to be dissolved in a tax qualified merger with another member of the 100% group or otherwise, any loss from the impairment or devaluation of the shares of the corporation shall, with effect from 30 June 2011, not be recognised. A similar treatment is applicable for the asset valuation loss at the time tax consolidation is introduced or triggered as a result of a tax disqualified share for share swap.

(2) For tax years beginning on or after 1 April 2011, a deduction is available for negative capital in computing the amount of taxable income of a liquidating corporation.

(3) Under the group taxation loss limitation rules, where a tax-qualified split-up, contribution-in-kind or dividend-in-kind is made under 100% capital relationship without there being the transfer of a business, the loss subject to limitation is calculated by reference to the unrealised capital gain on the transferred assets. The June Bill clarifies that unrealised capital gains on treasury stocks are not taken into account for the purpose of undertaking this loss limitation calculation.

(4) The special measures listed below that are otherwise applicable to corporations with capital not exceeding JPY 100 million (i.e., small and mid-sized ordinary corporations (SMCs) does not apply if all of their outstanding shares are owned by one or more corporations with capital JPY 500 million or more (Large Corporation) in the same 100% group. Prior to the June Bill, the special measures were not applied to a SMC that was wholly owned by a single Large Corporation, but applied to a SMC that was wholly owned by more than a single Large Corporation. Under the June Bill, regardless of the number of the parent Large Corporations, the special measure are not applied to SMCs for tax years beginning on or after 1 April 2011 (excluding years ending before 30 June 2011) .

- Lower corporate tax rate
- Exemption from taxation of excess retained earnings of family corporations
- Statutory rate method to estimate bad debt allowance
- Deductions for entertainment expenses
- Tax refund by tax loss carried back

Tax-qualified contributions-in-kind made by foreign corporations
(1) Contributions-in-kind that are carried out on or after 30 June 2011 by foreign corporations of property located outside Japan are no longer treated as tax-qualified contributions-in-kind.

(2) When a foreign corporation, with a branch PE in Japan, contributes assets of its Japan branch to a Japanese corporation in exchange for shares in the Japanese corporation on or after 30 June 2011, the two requirements that: i) the Japan branch must be kept open; and that ii) the shares of the Japanese corporation must be held by the Japan branch are no longer required in order for the transferor to avoid taxable capital gains arising. Thus, with effect from 30 June 2011, even if a foreign corporation fails to satisfy either of the two requirements, capital gains taxation will not apply.

International taxation

Foreign tax credit
In connection with the foreign tax credit regime, the June Bill introduced the following amendments:

(1) Where the applicable tax rates in a foreign country vary depending on an agreement with the foreign taxation authorities, any taxes in excess of the amount computed using the lowest applicable rate will be excluded for purposes of the foreign tax credit computation or the anti-tax haven rules. The amendment is effective for any foreign taxes paid on or after 30 June 2011.

(2) For the purposes of computing the foreign tax credit limitation, income of a corporation which may be taxed in a foreign country in accordance with the tax treaty between Japan and that foreign country shall generally be deemed to be treated as foreign sourced income for fiscal years starting on or after 1 April 2011.

Anti-tax haven (CFC) rules

(1) Under the CFC rules, a foreign corporation that would otherwise be treated as a CFC is exempted from the application of the CFC rules if it satisfies the conditions ("active business exception") listed below. When the main business of the CFC is holding securities as a regional headquarters corporation, the June Bill clarifies that the conditions, other than the business purpose test, will be judged based on the headquarters activities.

- Business purpose test
- Substance test
- Administration and control test
- Local country test or unrelated party test

(2) For purposes of computing the effective tax rate for CFC purposes, the June Bill has abolished the need to meet the shareholding requirements in order to exclude foreign dividends from the untaxed foreign income. As a result, tax-exempt foreign dividends will be fully excluded from untaxed income and thus will not need to be added back to the denominator of the CFC's effective tax rate computation.

"When the main business of the CFC is holding securities as a regional headquarters corporation, the June Bill clarifies that the conditions, other than the business purpose test, will be judged based on the headquarters activities."

(3) The June Bill clarifies that a gain on a dividend-in-kind from a CFC cannot be deferred when computing the CFC's taxable retained earnings under Japanese domestic tax principles. Thus, any gain that would otherwise be deferred will be recognised by the domestic corporate shareholder under the CFC rules.

(4) Other technical changes were made to the application of Japan's CFC regime. Many of these relate to the treatment of tainted income for CFC purposes. This including clarifications to the current tainted income exceptions.

The June Bill amendment are effective for Japanese corporations' tax years ending on or after 1 April 2011 where a CFC's income for its tax year beginning on or after 1 April 2010 is aggregated, except for (3) which apply to dividends-in-kind made on or after 30 June 2011.

Transfer pricing legislation

The June Bill in relation to transfer pricing is primarily designed to align applicable Japanese legislation with certain changes that were made to the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations in 2010 (OECD Guidelines).

The previous Japanese transfer pricing legislation provides that, only when the three traditional transactional methods were not applicable, a method similar to one of the three traditional transactional methods, or a method specified by a Cabinet Order (i.e., the Profit Split method or the Transactional Net Margin Method) may be applied. However, the June Bill clearly specifies that this priority between transfer pricing methods shall be eliminated, and – reflecting the wording adopted by the OECD Guidelines – the "most appropriate method" shall be applied in order to calculate an arm's length price.

This tax reform is applicable for accounting periods (business years) starting on or after 1 October 2011.

Financial Services

Taxation of securities

The current concessionary tax rate for dividends on listed stocks (i.e., 7% for corporations) is extended two years until 31 December 2013.

Expansion of tax exemption for interest received by foreign financial institutions entering into Saiken-Gensaki (Japanese Repo) transactions

(1) Interest on cash collateral and lending fees in relation to securities lending transactions (collaterised by cash or securities) received by foreign financial institutions (including insurers) will be exempt from corporate and withholding tax provided certain conditions are met (e.g., trading term is six months or less, etc).

(2) The following securities will be added as “assets” (in addition to the current scope covering Japanese government bonds (JGBs), foreign government bonds, etc.) subject to this exemption:

- Book-entry local government bonds;
- Book-entry corporate bonds;
- Book-entry bond type beneficiary interest issued by Special Purpose Trusts (without entitlement to voting rights on ancillary matters); and
- Listed stocks (when used in stock lending transactions).

These tax amendments will be applicable to interest and lending fees in relation to transactions commencing on or after 30 June 2011.

Clarification of tax exemption rule for book-entry JGBs and corporate bonds for non-resident investors

(1) A foreign pension fund formed as a trust based on a foreign country’s law and treated as a “pass” through trust for Japanese tax purposes will be eligible to apply for the tax exemption rule on interest on book-entry JGBs and corporate bonds.

(2) A non-resident or a foreign corporation investing in book-entry JGBs or corporate bonds through a Japanese partnership (nin-i kumiai) or similar foreign vehicle will be eligible to apply for the tax exemption rule on interest and redemption gains on book-entry JGBs and corporate bonds by certain procedures.

The tax concession will first apply to interest on book-entry bonds whose interest calculation period begins on or after 30 June 2011.

Consumption Tax

Amendment to the “base period” rule

A small business otherwise qualifying as an exempt enterprise under the “base period” rule will be required to become a taxpayer in any year immediately following the year in which the taxpayer has at least 10 million yen of taxable revenue during the first 6 months of the year. The amendment is effective for exempt periods beginning on or after 1 January 2013.

Amendment to the 95% rule

Under the previous rule, taxpayers are allowed full input tax credit if their taxable sales ratio is at least 95%. With the latest tax amendment, full input tax credit is only applicable to an enterprise whose annual taxable sales for the period is 500 million yen or less. For other enterprises, input tax credit is allowed based on either the percentage of taxable revenue method or the attributable method. The amendment is effective for taxable periods beginning on or after 1 April 2012.

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Korea

Tax reforms affecting insurers: K-IFRS implementation and recent proposed 2011 tax amendments

All Korean insurance businesses would have adopted Korean IFRS (referred to as 'K-IFRS') accounting standards with effect from 2011 and in so doing, implemented the K-IFRS accounting standard 1104 "Insurance Contracts" which is the equivalent of IFRS 4. In late 2010 the Korean Ministry of Strategy and Finance (MOSF) proposed a number of tax related amendments to specifically address the unintended consequences associated with the transition by Korean businesses to K-IFRS. The Korean National Assembly enacted these amendments earlier this year and in doing so, ensured that Korean businesses were able to benefit from these amendments at the time of implementation.

The MOSF has also recently proposed a basket of wide ranging reforms (the proposed 2011 tax amendments) which were announced in September of this year. The proposals include a continuation of the corporate income tax and individual income tax rate, as well as supplementary and retrospective changes designed to correct further anomalies arising from K-IFRS adoption.

In this article, we will examine the impact of the K-IFRS related 2010 tax amendments for insurance companies operating in Korea. We will also discuss the recently proposed 2011 tax amendments which are currently before the Korean National Assembly and their relevance for insurers.

The 2010 tax amendments

For insurers, the 2010 tax reform package contained a number of key amendments to clarify the taxation treatment of movements in the technical and equalisation reserves arising from the transition to K-IFRS. Both of these reserves were a regulatory requirement of insurance companies operating in Korea, and have typically represented a significant portion of the total liabilities that are carried by an insurer.

There had been problems associated with transitional adjustments and the new accounting treatment under K-IFRS. To address these problems, the Korean insurance associations held timely discussions with MOSF. In the end, the 2010 tax amendments took into account most of the opinions of the insurance associations and relieved the otherwise heavy tax burdens that could have resulted.

Technical reserves

Under the previous Korean GAAP, technical reserves were valued using a different methodology from that which is to be applied under K-IFRS 1104. The value of a technical reserve calculated using the new methodology is generally a larger figure. A question thus arose on whether the difference in reserve upon transiting from Korean GAAP to K-IFRS would be deductible.

The Corporate Income Tax Act (CITA) that was amended as part of the 2010 amendments has addressed this issue. Where an insurer implements K-IFRS, it is able to deduct as an expense the difference between the technical reserve that had previously been claimed for tax purposes and the new technical reserve calculated in accordance with prevailing statutory standards.

The statutory standards referred to in the CITA are those set by the Financial Supervisory Service (FSS), the regulatory body for insurance companies in Korea. As the valuation standard of the FSS for technical reserves is now the same as that under K-IFRS, this effectively means that technical reserves provided under K-IFRS should be fully deductible going forward.

Equalisation reserves (catastrophe reserve)

The previous K-GAAP had allowed non-life insurers to set aside equalisation reserves as liabilities. K-IFRS 1104 does not allow such a practice. Upon adoption of K-IFRS in 2011, the entirety of the reserve has been transferred to equity and included within the FY2011 opening balance of retained earnings.

The CITA used to only allow a deduction for equalisation reserves that are recognised as liabilities in an

insurer's financial statements. If there were no tax reform, the tax burden created by the reversal of the equalisation reserves was estimated to be in the order of KRW 800 billion. An unexpected tax hit of this size would be a significant outflow of insurance company capital, and may even have a knock-on effect on the financial soundness of some insurers.

Insurance companies in Korea were active in flagging this as an issue requiring legislative amendment. The MOSF discussed the treatment of equalisation reserves with Korean insurance associations. It was concluded that contributions to these reserves should continue to be tax deductible even though the reserve is not allowed as a liability under K-IFRS.

One of the 2010 tax amendments permits a deduction for 90% of the increases in an equalisation reserve which is still required to be kept under the applicable statutory standard set by the FSS. Korean insurance associations are however continuing to lobby the MOSF for a deduction equal to the full amount of these reserves.

Proposed 2011 tax amendments

Corporate income tax rate maintenance
The Grand National Party and the MOSF held a high-level consultation meeting regarding additional tax reforms for 2011 on 7 September 2011. It was agreed that the highest rate of corporate income tax, which is currently 22% (24.2%, including residential surtax), should be maintained and a middle income tax bracket be created to benefit small and mid-sized entities.

The continuation of the highest rate of corporate tax is a departure from the earlier intention signaled as part of prior tax reform packages. The highest corporate income tax rate was originally scheduled to be lowered from 22% to 20% in the tax year commencing 1 January 2010. It was subsequently deferred to take effect two years later from 1 January 2012. The maintenance of the top rate of corporate income tax has been explained as a measure intended to enhance the financial position of the government as the global financial crisis lingers.

Individual income tax rate maintenance
Complementing a reduction in the top corporate income tax rate, the highest individual income tax rate was also originally scheduled to be lowered from 35% to 33% with effect from 1 January 2012. As noted in the proposed 2011 tax amendments, this reduction has now been cancelled.

Reversal of bad debt provisions
The previous K-GAAP accounting standards permitted a bad debt provision to be raised against a receivable where it was considered by management that it would not be recovered in full. A more stringent requirement now applies under K-IFRS which only permits a bad debt allowance to be booked where there is objective evidence of the irrecoverability of a debt. Most insurers in Korea had to reverse a significant portion of their bad debt allowances upon the adoption of K-IFRS. This had the potential to trigger a large amount of taxable income in the transitional year given that a deduction had been claimed with each acretion to the bad debt provision.

Under the 2010 tax amendments, any income triggered by a reversal of a bad debt provision arising from a movement to K-IFRS is deferred for 2 years. The deferred income is then netted off against any deductions for bad debts during the deferral years. In its original form, this concession only applied to entities which had been established in Korea. It was not available to by the Korean branches of foreign resident enterprises. The MOSF has now sought to redress this asymmetry, and has proposed to extend this concessionary measure to the Korean branches of foreign residents as part of the proposed 2011 tax amendments.

Deduction of Loss Adjustment Expense ("LAE") reserve
Under the previous K-GAAP accounting standards, claim investigation fees were recognised as an both an accounting expense and a deductible outgoing when the fees were actually paid. Accumulated future claim investigations fees can now be recognised in the LAE reserve that is treated as a liability under K-IFRS 1104 and under the applicable FSS statutory standards. It is proposed by the 2011 tax amendments that this reserve will be included as a new type of technical reserve that should be tax deductible to an insurance company.

"The continuation of the highest rate of corporate tax is a departure from the earlier intention signaled as part of prior tax reform packages. The highest corporate income tax rate was originally scheduled to be lowered from 22% to 20% in the tax year commencing 1 January 2010."

Conclusion

The adoption of K-IFRS accounting standards has been a significant exercise for insurance companies operating in Korea. To manage the potential unintended tax consequences, the Korean insurance associations have worked closely with MOSF to ensure that timely and effective legislative amendments are enacted to assist a smooth transition by insurers to the new standards. The coming together of regulators and taxpayers in this fashion has proved productive as evidenced by the 2010 amendments and the proposed 2011 tax amendments.

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Malaysia
Tax incentives for operational headquarters and shared services

The insurance industry in Malaysia has been affected by the challenging external conditions posed by the global financial crisis but has generally remained resilient.

Despite the recent economic woes, the cost of doing business has been increasing and insurance companies have not been spared. Controlling costs and maximising efficiency are some of the important factors needed to remain competitive. The question of whether to establish a shared cost centre or regional head office for a group of companies is part of this equation and has become a more topical issue in recent times. Once a decision has been made by a multinational to establish a hub for intra-group services, the follow-on question then becomes a decision on a suitable location.

The government of Malaysia continues to introduce initiatives to strengthen and enhance the role of the financial services sector as an enabler of, and catalyst for, economic growth. Against this background there exists a number of attractive tax incentives available for back office operations and regional head office support. Set out below is a brief summary of the two most popular incentives (i.e. Operational Headquarters and Multimedia Super Corridor status) and their potential application to multinational insurance companies.

Approved Operational Headquarters

An approved operational headquarters (OHQ) refers to a locally incorporated company that carries on business in Malaysia to provide qualifying services to its offices or related companies located within and outside Malaysia.

Tax concession
An approved OHQ will be exempted from income tax for a period of 10 years on the following sources of income:

- Business Income – Income arising from services rendered by an OHQ to its offices or related companies outside Malaysia is wholly exempted from income tax. Income arising from services rendered to a related company in Malaysia is permitted up to a 20% limit only (based on a prescribed formula).

- Interest – Income derived from interest on foreign currency loans extended by an OHQ to its offices or related companies outside Malaysia.

- Royalties – Royalties received from research and development work carried out in Malaysia by an OHQ on behalf of its offices or related companies outside Malaysia.

Qualifying criteria
The eligibility criteria for an approved OHQ are not difficult to fulfill. Some of those conditions are set out below:-

- Malaysian incorporated company under the Companies Act 1965;

- A minimum paid-up share capital of RM0.5 million;

- A minimum operating expenditure of RM1.5 million per year;

- Appoint at least three senior professional/management personnel;

- Serve at least three related companies outside Malaysia;

- A well established network of companies with significant and substantial employment of qualified professionals and technical and supporting personnel; and

- Carry out at least three qualifying services (e.g. general management and administration, business planning and coordination, marketing control and sales promotion planning, data and IT information management. There is a prescribed list of qualifying services.).

A US-based global insurance and reinsurance company from Singapore[1] has set up an approved OHQ in Malaysia to provide technical support and maintenance, data/information management and processing, research and development and training and personnel management to its affiliated companies within the group.

Multimedia Super Corridor Status

Another option which can be considered is the Multimedia Super Corridor (MSC) status. The MSC in Malaysia is intended to assist in nurturing the nation's information and communications technology industry. It provides a

[1] Malaysia: Performance of the Manufacturing and Services Sectors 2007, issued by Malaysian Investment Development Authority (MIDA)

perfect environment for companies wanting to create, distribute and employ multimedia products and services.

Several leading insurance groups have established their shared services operations in Malaysia and some have been granted the MSC status[2]. Generally these MSC status companies operate as regional information technology hubs, processing centres or data centres. They may also be used by insurance groups in Asia to act as a platform for both inbound and outbound customer call centres.

The MSC incentive is available for both Shared Services and Outsourcing (SSO) centres:-

- Shared Services - a model where common services are provided under a single, shared organisation leveraging on economies of scale, e.g. outsourcing, call centre consolidation, etc.

- Outsourcing - results orientated shared service partnership with an external service provider. e.g. business process outsourcing (BPO), IT outsourcing, etc.

Tax concession
The income tax incentives for companies with MSC status are:-

- Pioneer status incentive on 100% statutory income for 5 years (extendable to 10 years); or

- 100% investment tax allowance on qualifying capital expenditure for 5 years to be utilised against statutory income for 5 years.

With effect from 1 October 2002, non-resident companies are exempted from payments of income tax in Malaysia in respect of the following types of income received from the approved MSC Malaysia status company:-

- Payment for technical advice or technical services;

- Licensing fees in relation to technology development; and

- Interest on loans for technology development.

Qualifying criteria
Companies (including companies providing SSO) seeking MSC status plus tax incentives will need to meet the following criteria –

- Establish a separate legal entity for the MSC activities;

- Be a provider / developer / heavy user of multimedia products and services;

- Employ a substantial number of knowledge workers;

- Provide technology transfer and/or contribute towards the development of the MSC Malaysia or support Malaysia's knowledge-economy initiative; and

- Locate in one of the MSC Malaysia designated cyber cities or cyber centres.

In addition to the above, companies performing SSO activities intending to apply for MSC status must satisfy the following additional criteria:-

- More than 70% of the revenue must be from outside Malaysia;

- 70% of investment/operation to be in MSC-designated area within 6 months of MSC Malaysia approval;

- Have minimum 100 employees by the 3rd year of operation; and

- Employ at least 85% knowledge workers.

"Several leading insurance groups have established their shared services operations in Malaysia and some have been granted the MSC status[2]. Generally these MSC status companies operate as regional information technology hubs, processing centres or data centres. They may also be used by insurance groups in Asia to act as a platform for both inbound and outbound customer call centres."

[2] www.mscmalaysia.my

Conclusion

Malaysia has a lower cost structure compared to many of its neighbours and the widespread use of English as the business language puts the country ahead. The Malaysian insurance sector is projected to grow as the current penetration rate is still relatively low. The life insurance and family takaful (Islamic life) space are still largely untapped. Hence, there is still ample room in the local market for players to capitalise on organic growth as a strategy and proper tax planning, including exploring appropriate tax incentives will be a critical success factor for a successful insurance business.

The above factors make Malaysia a suitable choice as a preferred location.

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New Zealand Taxation issues for foreign insurers and reinsurers entering the New Zealand market

A recent survey[1] of the risks facing the global insurance industry suggests that there is an opportunity for foreign insurers and reinsurers to take advantage of a New Zealand market more informed and open to the benefits of insurance.

In light of this, this article summarises the key tax issues foreign insurers should consider when looking to invest into New Zealand. It includes a high level consideration of the tax implications of common insurance business models which foreign insurers can use to enter the New Zealand market, together with the GST considerations which are of relevance to the insurance industry.

Principles of taxation

Liability to New Zealand tax is determined on the basis of the concepts of 'residency' and 'source'. The world-wide income of New Zealand 'residents', whether they are companies or other entities, is generally subject to New Zealand income tax. A company is taken to be tax resident of New Zealand, if:

- It is incorporated in New Zealand; or
- It has its head office in New Zealand; or
- It has its centre of management in New Zealand; or
- Directors exercise control of the company in New Zealand, whether or not the directors' decision making is confined to New Zealand.

The taxation of the world-wide income of New Zealand tax residents may be contrasted with non-residents who are only taxed on their New Zealand sourced income. A single rate of corporate tax applies to the income of both resident and non-resident corporate taxpayers. The current rate of 30% reduces to 28% with effect from the 2011/2012 income year.

Life insurance

From 1 July 2010, new rules apply to the taxation of life insurance companies. Under these rules, income from a life insurer's business is separated into:

- shareholder income (income earned by the equity owners in the company); and
- policyholder income (income earned for policyholders from life insurance products).

Shareholder income is taxed at the corporate tax rate in a similar manner to other businesses. Policyholder income, on the other hand, is taxed under the New Zealand portfolio investment entity (PIE) rules. The tax treatment of saving through life insurance policies is therefore the same as saving through other investment products.

Non-life insurance

Non-life insurance companies that are either resident in New Zealand or have a fixed establishment are taxed in the same way as other companies but are also subject to industry specific rules. In New Zealand, the taxation of non-life insurers is closely aligned to accounting income recognised through the application of IFRS standards.

Business models

Businesses entering the market have a range of business models available to them through which they can carry on their business in New Zealand. Some of these models, as well as their associated tax implications, are discussed below.

New Zealand agents

It is common for foreign insurers to underwrite business overseas and contract with New Zealand residents directly or via local agents. In such cases, the foreign insurers have no physical presence in New Zealand.

Key tax matters to note include:

- The foreign insurer is not taken to be a New Zealand resident and is not subject to the full corporate tax rate of 28% on insurance profits.
- The foreign insurer is still taxed on 10% of the premiums received. The effective tax payable is 2.8% (i.e. 10% x corporate tax rate of 28%) on gross premiums received. This only applies to non-life insurance.
- The New Zealand agent of the foreign insurer is liable to furnish income tax returns and pay the tax assessed on behalf of the foreign insurer. However, this obligation shifts to the foreign insurer if the agent defaults.

[1] PwC publication: Insurance Banana Skins 2011

• Only the New Zealand – Switzerland double tax agreement currently provides relief from the 2.8% tax for premiums paid to a Swiss based insurer / reinsurer (Swiss tax resident). In all other cases protection under a double taxation agreement will not be available for the imposition of tax on insurance premiums.

Branch structures

Foreign insurers could also consider establishing a branch in New Zealand (NZ Branch). Under this business model a NZ Branch will typically underwrite its own business within limits set by Head Office.

The NZ Branch generally performs sales and marketing, underwriting claims management and other activities related to the New Zealand business with various high level management and strategic support received from Head Office.

Key tax matters to note include:

• NZ Branch is subject to the corporate tax rate of 28% on branch profits.

• Transfer pricing and questions of profit attribution must be considered depending on the range of related party services undertaken by the NZ Branch.

• Both tax paid and non-taxed accounting profits can be repatriated tax free out of New Zealand.

• NZ Branch is not required to maintain an imputation credit account.

• Tax losses can be carried forward subject to New Zealand shareholder continuity rules. No carry-backs of losses are permitted in New Zealand.

Local insurance subsidiaries
The foreign insurer could also establish an incorporated subsidiary in New Zealand (NZ Subsidiary).
This is substantively the same as the usage of a branch structure, with the incorporation of a subsidiary instead of merely registering the foreign insurer as a branch.

Key tax matters to consider:

• NZ Subsidiary is generally considered to be a New Zealand resident, but there can be potential dual residency issues depending on the level of involvement of the foreign parent.

• Transfer pricing must be considered with adequate documentation retained to support related party transactions.

• Tax paid profits can typically be repatriated out of New Zealand without further costs but repatriation of non-taxed profits is often subject to withholding tax (subject to treaty relief).

• NZ Subsidiary is required to maintain an imputation credit account.

• Tax losses can be carried forward subject to New Zealand shareholder continuity rules. No carry-backs of losses are permitted in New Zealand.

Goods and Services Tax (GST)

New Zealand has a value added tax called GST. Unlike many other jurisdictions, GST taxes non-life insurance. It does this by, in effect, taxing cash flows. Life insurance is exempt from GST.

The standard 15% rate of GST is generally imposed on inward cash flows such as premiums and subrogation recoveries. GST on outward cash flows such as overhead expenses and claim settlements can be recovered by deduction against GST payable on premiums and subrogation recoveries.

There is no refund mechanism for non-resident businesses as exists in some other jurisdictions such as the EU/ UK. The only way GST costs can be recovered is for a non-resident to register for GST which will give rise to the requirement to charge GST on supplies that are “made in New Zealand.” GST costs can be recovered by way of a deduction against GST which is accounted for on sales as “output tax.”

Foreign insurers entering the New Zealand market therefore need to consider whether and to what extent significant GST costs will be incurred in New Zealand. Such costs include those associated with settling claims (eg. legal fees in the case of liability claims, restitution / repair costs in the case of property claims). If a foreign insurer is not registered for GST, the costs of settling claims will include GST at 15%.

Registering for GST
If a foreign insurer leases / owns premises in New Zealand, they will be treated as being “resident” for GST purposes and all business attributable to that presence will be subject to GST. Registration will be mandatory if the value of non-life insurance premiums supplied by the insurer exceeds NZ$60,000 per annum.

“Only the New Zealand – Switzerland double tax agreement currently provides relief from the 2.8% tax for premiums paid to a Swiss based insurer / reinsurer (Swiss tax resident). In all other cases protection under a double taxation agreement will not be available for the imposition of tax on insurance premiums.”

“Registration for a foreign insurer is mandatory, if the recipient of the supplies is not GST-registered and the value of the supplies (premiums) exceeds NZ$60,000 per annum.”

Registration is also possible for a foreign insurer if it supplies services which are physically performed by any person in New Zealand. Such supplies are made “in New Zealand” for GST purposes.

It is also common for foreign insurer to issue policies through an agent. For GST purposes, agents are a “look through”. The relevant GST obligations are imposed on the principal and not the agent. Registration for GST will therefore depend on whether the non-resident makes supplies in New Zealand.

Supplies to GST-registered insureds
Registration is optional if the New Zealand recipient of the services is GST-registered and makes taxable supplies.

If the foreign insurer decides to opt in to GST registration it will be necessary to agree with each New Zealand business insured that a specific provision in the GST legislation does not apply and its services are supplied ‘in New Zealand’ for GST purposes. It is important that this agreement is put in place as it ensures that the foreign insurer can charge and account for GST on premiums. As the recipient business insured is GST-registered, the GST charged on premiums should not be a cost to them.

If the foreign insurer decides not to register for GST, claims should be settled on a GST-exclusive basis where possible.

Supplies to non-GST registered insureds
Registration for a foreign insurer is mandatory, if the recipient of the supplies is not GST-registered and the value of the supplies (premiums) exceeds NZ$60,000 per annum.

Other taxes

Unlike other jurisdictions, New Zealand does not have a capital gains tax regime. However, gains made from investment activities are generally subject to income tax on the basis that they are part and parcel of the insurance business.

Stamp duty has been abolished in respect of instruments executed after 20 May 1999.

There are no special provisions in the New Zealand tax legislation which apply to captive insurance companies. New Zealand captives are subject to the same tax and regulatory provisions as would apply to other insurance companies.

Regulatory environment

The Prudential (Insurance Supervision) Act 2010 was enacted in September 2010 and appoints the Reserve Bank of New Zealand as the regulator for the New Zealand insurance industry.

The Act is designed to bring the insurance industry in line with international best practice. Insurers will need to be fully licensed by September 2013 to operate and will need to comply with new solvency standards and other regulations. Some limited exemptions do apply for overseas insurers/ reinsurers.

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Papua New Guinea GST issues for the insurance industry

The supply of goods and services in Papua New Guinea (PNG) by a GST-registered person on or after 1 July 1999 is subject to a Goods and Services Tax (GST) at the rate of 10%.

The provision of non-life insurance is a taxable supply, while the provision (and reinsurance) of life insurance is treated as an exempt financial supply.

Insurance companies, brokers, agents and associated entities are faced with a number of issues peculiar to their industry as a consequence of GST. In this article, we outline some of these issues.

Tax invoices and documentation

The earlier of the date of issue of an invoice or the time any payment is received is defined as the time of supply. It is from this date that the supplier of a service becomes liable to account for GST (unless the supplier is on a payment basis). Generally, for most insurers, the issue of a tax invoice has the effect of creating a GST liability.

Debit and credit notes

Adjustments will frequently be made to policies, and accordingly to the premium details contained in the tax invoice which supported the initial supply of insurance services. In cases where the insurance policy has been cancelled or the previously agreed premium has been altered, an adjustment is required in the GST return covering the period in which the change is noted.

Business transacted through brokers

Where insurance is transacted through a broker, it is normal for an invoice to be created by the broker when they bill their clients (the policyholders). This will be a tax invoice that will have the effect of creating a GST liability to the insurers for the policies in respect of which the tax invoice is prepared.

The Insurance Council has made a decision, which has been agreed to by the Internal Revenue Commission (IRC), for members to record their GST liability on the net premium received, after taking into account the broker's commission, at the time they process the premium through their books. This will usually be the time that the closing is received from the broker.

Agents' invoices

Agents who are GST-registered will also issue tax invoices in their own right. These will be for commissions, hourly charges, direct brokerage and any other taxable supplies.

Claims

Availability of input tax credits on indemnity payments for non-life insurers

The GST Act specifically allows non-life insurers to claim a GST input tax credit (one eleventh of the gross payment whilst the GST rate remains at 10%) of claims settled by way of indemnification payment rather than by the supply of replacement goods.

This provision does not apply where:

- The insurance was an exempt or zero-rated supply, or
- The payment is in respect of the supply of goods or services to the insurer, or the importation of any goods by the insurer. This is to prevent a double claim being made as an insurer will hold a tax invoice from the supplier of the replacement asset and will be able to claim a GST input tax credit under the provisions applicable to other taxpayers.

The provisions of the GST Act allow a GST input tax credit for indemnity payments to be claimed only on a payments basis. Therefore, a GST input tax credit cannot be claimed on an outstanding indemnity claim until a payment is made.

Treatment of insurance recoveries

Where a GST-registered person receives indemnity payments (including recoveries from resident reinsurers), the payments are deemed to be in return for a supply of services in the GST return period in which they are received. GST output tax is accountable at the rate of 1/11th of the gross payment received for the deemed supply.

There are no special provisions applicable to claims made and indemnification payments received by unregistered persons. The insurer will still be eligible for an input tax credit provided the supply of the contract was subject to GST.

If the sum insured has been increased to account for any price increase attributable to GST and a loss is incurred, the insured will receive an indemnification payment equal to the cost of replacing or reinstating the asset.

Local reinsurance

Premiums
For GST purposes, locally placed reinsurance is a supply of a service and the reinsurer will be required to account for GST on the services provided. The provision of non-life reinsurance is taxable while the provision of life reinsurance is exempt.

Details of reinsurance placements are normally provided by the insurer to the reinsurer rather than vice-versa. Accordingly, this is another situation where "buyer created tax invoices" by the insurer can be used and is acceptable to the IRC provided the relevant requirements are satisfied.

Recoveries
In general, non-life insurers will be able to claim a credit for the GST paid on claims. Where part or all of a claim is recovered from a reinsurer, an adjustment is required to recognise this.

As noted above, under the GST Act, any indemnity payment received pursuant to a contract of insurance (including reinsurance) is deemed to be consideration for the supply of services. The recipient (being the insurer in the case of reinsurance recoveries) is accordingly required to account to the IRC for the GST component (one-eleventh) of the recovery.

Overseas reinsurance

Premiums
Premiums paid to non-resident reinsurers will still be subject to GST where the services (i.e. the provision of reinsurance) are performed outside PNG for the use or benefit within PNG of a person resident in PNG.

Reverse charge rule
Services which are supplied by a non-resident reinsurer to a GST-registered insurer in PNG are subject to GST by the operation of the reverse charge rule. Where this rule applies, the insurer will act as an agent for the reinsurer and will increase the amount charged by the GST component. This amount is then accounted for by the insurer.

To the extent that the reinsurance services relate to the making of a taxable supply, a GST input tax credit will then accrue to the insurer in the same taxable period and will therefore ensure that no additional direct cost is incurred.

It would be anticipated that most insurers will account for the reverse charge rule by the operation of a journal entry at the end of each month to show the GST output tax on imported reinsurance and the corresponding GST input tax credit. However, the specific treatment will depend on each insurer's accounting system.

Where the offshore reinsurance would be an exempt supply, e.g. in respect of the provision of life insurance, there is no need to self assess GST under the reverse charge rule as the reverse charge rule does not apply to exempt supplies.

Recoveries
Where a recovery is received by a resident insurer from an overseas reinsurer, this will be treated as being for a supply of services by the insurer. Where the recovery is from a non-resident, non-GST-registered reinsurer, the deemed supply shall be an exported supply and therefore subject to GST at the rate of zero percent.

"Where a recovery is received by a resident insurer from an overseas reinsurer, this will be treated as being for a supply of services by the insurer. Where the recovery is from a non-resident, non-GST-registered reinsurer, the deemed supply shall be an exported supply and therefore subject to GST at the rate of zero percent."

The overseas reinsurer will not have any additional costs as they have not paid any GST and the resident insurer will not need to increase the sum recovered for GST. Therefore the overseas reinsurers receive no advantage nor suffer any disadvantage from GST. They are effectively in the same position as their resident counterparts.

Exported insurance services

Where a PNG resident insurer provides insurance or reinsurance to a non resident, non registered insured, this will be a supply of exported services and subject to GST at the rate of zero percent (zero-rated). This ensures that the overseas insured is not disadvantaged by the payment of non-recoverable GST.

Where the supply of exported services is charged with GST at the rate of zero percent, the resident insurer will be entitled to receive a GST input tax credit for any GST paid on purchases (inputs) used in making that supply, subject of course to the requirements of the GST Act being met.

Assets situated overseas
The supply of insurance cover (a service) over assets that are situated overseas to a non-registered, non-resident insured is charged with GST at the rate of zero percent.

Cover provided to non-residents
Where insurance cover is provided to non-residents, this will be an exported service provided the non-resident is not registered for GST purposes. Where insurance is provided to tourists and other visitors whilst in PNG, the supply will be a taxable supply. GST will therefore apply at the rate of 10% to the extent that the cover is provided in PNG.

Effect of GST on sums insured

In the non-life insurance industry, a common question asked by both insurers and insured parties is whether the sum insured should include GST. Some registered businesses may feel that they do not need to increase the level of cover to account for GST, as an input tax credit will be available for any GST paid, say, on the replacement assets.

This approach is incorrect as it fails to take account of the procedures required when the insured receives a cash indemnity payment from the non-life insurer. The GST Act deems any indemnity payments received by a registered person to be consideration for the supply of services and therefore one-eleventh of the amount received will be accountable to the IRC.

Conclusion

The imposition of GST on payments made and received in relation to policies of insurance is a complex area. As discussed above, insurers operating in PNG can potentially be taken to make exempt, standard rated and zero-rated supplies depending upon the policies that are issued and the nature of their insurance and reinsurance arrangements. It is fortunate that the provisions of the GST Act are relatively static and not subject to much in the way of ongoing legislative change. While resource constraints within the IRC remains an ongoing issue, insurers should be mindful of the risk of additional tax should their GST compliance be audited by the IRC and found to be inadequate.

“Where insurance is provided to tourists and other visitors whilst in PNG, the supply will be a taxable supply. GST will therefore apply at the rate of 10% to the extent that the cover is provided in PNG.”

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Philippines
DST on life insurance policies

Earlier this year, the Supreme Court (SC)[1] upheld the assessments issued by the Bureau of Internal Revenue (BIR) on documentary stamp tax (DST) involving two types of insurance products offered by an insurance company. These are ordinary term life insurance policies referred to as the "Money Plus Plan" and group life insurance policies.

The BIR assessed the respondent insurance company of deficiency DST based on the increases in the life insurance coverage of these policies.

Even though amendments have been made to the provisions of the Tax Code which have changed the calculation base for DST on policies of life insurance, this decision remains highly relevant.

In this case, the SC once again applied the substance over form approach in the imposition of DST.

The "Money Plus Plan"

The Money Plus Plan is a 20-year term ordinary life insurance plan with a "Guaranteed Continuity Clause" which allowed the policy holder to continue the policy after the 20-year term. Under the continuation clause, a policyholder is entitled to renew the policy for another twenty years by providing proof of insurability that is acceptable to the insurance company, and paying a revised premium based on the current rates at the time of renewal.

In its decision, the SC noted that fundamentally DST is a tax: "on documents, instruments, loan agreements, and papers evidencing the acceptance, assignment, sale or transfer of an obligation, right or property incident thereto." [2] The SC rationalised DST on the basis that it is in the nature of an excise tax that is imposed on the privilege of conducting insurance business:

"To elucidate, documentary stamp tax is levied on the exercise of certain privileges granted by law for the creation, revision, or termination of specific legal relationships through the execution of specific instruments… Documentary stamp tax is thus imposed on the exercise of these privileges through the execution of specific instruments, independently of the status of the transactions giving rise thereto."

The SC held that the text of the guaranteed continuity clause is clear since what the respondent insurance company was actually offering in its Money Plus Plan was the option to renew the policy after the expiration of its original term. The Court noted that this renewal was subject to the acceptance between the parties of differing contractual terms. It was not merely an agreement to increase the coverage of an existing life insurance policy within the scope of an original contract of insurance.

Consequently, the acceptance of this offer would give rise to the renewal of the original policy which shall be subject to DST under Section 183 as insurance renewed upon the life of the insured, which then read:

"SEC. 183. Stamp Tax on Life Insurance Policies. — On all policies of insurance or other instruments by whatever name the same may be called, whereby any insurance shall be made or renewed upon any life or lives, there shall be collected a documentary stamp tax of Fifty centavos (P0.50) on each Two hundred pesos (P200), or fractional part thereof, of the amount insured by any such policy." [3]

The SC, however, did not specifically indicate which of the documents needed for the extension of a policy under the Money Plus Plan is actually subject to DST. One would assume that this pertains to the supplementary document setting out both the revised insured amount and the premium payable.

Group life insurance

The application of DST to group life insurance policies issued by the respondent insurance company was considered alongside the particulars of the Money Plus Plan.

Generally speaking, when a group insurance plan is taken out, a group master policy is issued with the coverage and premium rate based on

[1] G.R. No. 169103 dated March 16, 2011
[2] G.R. No. 172045-46, June 16, 2009.
[3] It should be noted that, currently, on the Tax Code provides that the premium collected, the not DST amount

the number of the members covered at that time. In the case of a company group insurance plan, the premiums paid on the issuance of the master policy cover only those employees enrolled at the time such master policy was issued. When the employer hires additional employees during the life of the policy, these individuals may be covered by the same group insurance already taken out without any need for the issuance of a new policy. The group policies issued by the respondent insurance company followed these norms.

Consistent with the approach taken in relation to the Money Plus Plan, the SC ruled that the admittance of another member into the policy means that another life is insured and covered. It does not matter that it did not issue another policy to effect this change - insurance on another life is made and the relationship of insurer and insured is created between the insurance company and the additional member of that master policy. The SC concluded that the enrolment card issued to each new employee admitted to a group policy forms part of the contract of insurance. It is the issue of this additional document which crystallises a liability to DST.

Conclusion

While the BIR's deficiency DST assessments were based on the increases in the life insurance coverage of the policies in question, these assessments were upheld by the SC on the basis that a new insurance relationship had either been renewed or created by the respondent insurance company with a policyholder.

Accordingly, the DST on insurance policies, though imposed on the document itself, is actually levied on the privilege to conduct insurance business.

"The SC concluded that the enrolment card issued to each new employee admitted to a group policy forms part of the contract of insurance. It is the issue of this additional document which crystallises a liability to DST."

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Insuring against the risks of the Goods and Services Tax (GST)

Like other tax authorities, the Inland Revenue Authority of Singapore (IRAS) is increasingly adopting a risk-based approach to tax risk management and governance. We see this in the recently launched Assisted Compliance Assurance Programme (ACAP) for GST compliance. We have also experienced instances where the IRAS has made enquiries of taxpayers' tax controls and risk management framework from a corporate income tax perspective.

In this article, we will discuss the IRAS' ACAP initiative and discuss the steps you could take for your business. We will also discuss what the IRAS expects to see in a well managed GST compliance environment, which in our view, is equally applicable to the management of income tax risks.

Understanding the ACAP

It is trite to say that insurance companies operating in Singapore need to ensure that they have good controls in place to track and report the amount of GST payable and recoverable on everyday transactions. GST compliance remains an ongoing issue that can be costly to manage. It is therefore timely for insurance companies, and taxpayers more generally, to pay attention to the recently introduced ACAP.

The ACAP is a new GST compliance initiative that sets out the IRAS's expectations of a taxpayer's framework for good GST governance and risk management. What is significant and first of its kind in the world is the IRAS's proposal to co-fund 50 per cent (capped at S$50,000 for a limited period) of the costs of engaging a qualified adviser or CPA firm with accredited specialists in GST to assist a taxpayer in its ACAP review. To further encourage and support the cooperative compliance effort, there will be a full waiver of penalties for non-fraud errors that arise from, and voluntarily disclosed in, the ACAP review.

The IRAS is aware of the practical reality that it is simply not possible for all errors in GST treatment and reporting to be identified. On the other hand, the IRAS believes that the stronger the GST controls and risk management framework implemented by a taxpayer, the fewer the errors that are likely to be made in their GST returns.

The ACAP sets out the IRAS's expectations of what the taxpayer should have in terms of an adequate and robust control framework to critically identify, assess and mitigate GST risks within its business.

"The ACAP sets out the IRAS's expectations of what the taxpayer should have in terms of an adequate and robust control framework to critically identify, assess and mitigate GST risks within its business."

What does the IRAS expect in an ACAP?

The GST has become an important contributor to tax revenues. It accounted for about 24 per cent of the taxes collected by the IRAS for the last financial year and has almost tripled in the last decade in dollar terms (S$8.2 billion).

Despite the growing importance of the tax, the general experience is that the GST is not being properly managed as a business compliance process. It is perceived that taxpayers continue to regard the GST as a by-product of their accounts receivable and accounts payable systems. The fact that the IRAS generally collects more in additional tax and penalties from GST audits (compared to direct tax audits) supports this view.

All this is intended to change with the ACAP. The IRAS has now detailed the controls and standards that they expect to see in GST governance and risk management, including:

- Senior management's commitment and oversight;
- Clear responsibilities and accountabilities;
- Highly skilled person or team to deal with the GST;
- Strong controls and documentation;
- Sound systems with accurate tax coding;
- Effective data extraction and compilation process for GST reporting.

The IRAS has indicated that the above features should be defined and present in the key controls at the entity level, transaction level and the GST reporting level.

There is also a strong indication that the IRAS would like to see the GST and the ACAP framework go on the agenda of the Board or the audit committee of a taxpayer.

"There is also a strong indication that the IRAS would like to see the GST and the ACAP framework go on the agenda of the Board or the audit committee of a taxpayer."

What does this mean for your business?

What does this mean for you? Are you ready, willing and able to participate in a self review of your structure, systems and processes to see if they meet the requirements of the ACAP and enjoy the benefits of a full waiver of past errors so that you start the next quarter with a clean slate? Is the co-funding the icing on the cake that would make you embark on the review?

While most insurance businesses would like to believe that they are in general compliance with the GST rules, the volume of transactions and the varied application of the tax in the different facets of the insurance business make it practically impossible for all risks to be detected (or to even identify where these may potentially lie). With the tax and the insurance business having its own risk profile, the ACAP should warrant some further discussion at the senior management level to see what features can be adopted to strengthen indirect tax function effectiveness.

The control features from the ACAP framework mean that insurers should, at the very least, be asking themselves the following questions:

- Do we have a structure and a visible function that is properly trained to handle and evaluate the impact of GST on our insurance business transactions; seeking professional advice as required?
- Is there a clear and documented process to escalate potential issues and risks (compliance and processing) to management?
- Do our people understand what is acceptable and unacceptable tax risk?
- Are our accounting systems sufficiently automated and robust to protect the integrity of our data and have the right tax coding and classification rules to distinguish taxable and non-taxable transactions within the insurance business and ensure the completeness and accuracy of our GST reporting?
- If not, what further controls and safeguards should be incorporated to avoid a time-consuming and costly audit by the IRAS?
- What regular checks and reviews are done to ensure that our controls are current and present?
- How much am I willing to pay for the peace of mind that my GST systems and controls are well established and working effectively?
- How does volunteering for an ACAP review change my risk profile and relationship with the IRAS?

Conclusion

The ACAP is the single most important compliance initiative by the IRAS in recent years. While we at PwC have observed similar risk-based approaches to tax risk management and governance taken by overseas tax jurisdictions, the IRAS's offer of a co-funding of the costs and the full waiver of penalties is bold and the first of its kind. It is nevertheless a reflection of how serious the IRAS views GST compliance.

Developing a strong and robust risk management framework for GST compliance is quickly becoming a necessity. The IRAS offers some good reasons for GST to have a place on your management agenda especially when compliance errors can lead to penalties and reputational risk.

In fact, managing tax risks is not just about the GST but direct income tax as well. It will not be surprising if the ACAP framework is subsequently adapted and rolled out to cover income tax risks at some point in the future.

Is it not time for insurance companies to consider taking up the ACAP as an "insurance policy" to manage its GST risks?

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Taiwan
Taxing issues: keyman insurance, IFRS and Luxury Tax

This article provides a brief overview of three current issues which are of relevance to insurance companies operating in Taiwan. The first is a consideration of the taxation character of payments made under a keyman insurance policy. A lack of clarity in this area has the potential to give rise to unintended consequences which are yet to be resolved. The second issue is the rapidly approaching date for the adoption of IFRS by financial institutions and insurers. Finally, a general introduction to the luxury tax and its relevance to the insurance industry is provided.

Unresolved tax issues for keyman insurance

Keyman insurance is a relatively standardised insurance product which is becoming more popular in Taiwan. It is a life insurance policy that is taken out by an employer over the life of a key employee or officer who is considered to be integral to the success of the employer's business. It is intended to compensate for the financial losses that would arise from the death, extended incapacity or critical illness of the insured individual. Despite their increasing prevalence, there are no specific tax rules and regulations which apply to payments made in relation to these products. The general rules on the taxation and deductibility of insurance related payments would likely apply.

Insurance compensation paid to an employer company (i.e. the underlying beneficiary of the policy) is subject to corporate income tax under Taiwan's current tax regulations. A company will often seek to claim a tax deduction for the premiums paid under the policy. There is however the potential for a tax mismatch to occur where the beneficiary to such claims is changed from the company to the individual and/or his family. According to Article 4 Item 7 of the Income Tax Act, compensation paid under a life insurance policy to an individual is exempt from income tax. Asymmetry can arise if a tax deduction has been claimed by the company on the premium paid and yet, the payout to the individual and/or his family would be exempt from income tax.

Furthermore under Taiwan's general insurance environment, disability indemnity is normally paid to the disabled (i.e. the individual), not his employer. Since such disability indemnity payments will be exempt in the hands of the individual, this leads to the next question as to whether the premium paid by the employer should be clawed back or whether a deduction should not have been granted from the outset.

Despite Taiwan's relatively developed insurance industry, there is lack of clarity on the taxation and deductibility issues relating to these insurance policies. The likelihood for the tax authorities to rely on the existing tax regulations may not yield a fair or even appropriate result. Corporate taxpayers should therefore seek to understand the potential tax exposures when purchasing a keyman insurance policy.

Significant tax impact on special reserves upon conversion to IFRS

Based on current timelines, Taiwan listed companies and financial institutions are required to adopt IFRS in 2013. For enterprises operating in other industries, adoption of IFRS will apply in 2015.[1]

The conversion to IFRS in 2013 may have material tax impact to financial institutions. Particularly for the insurance sector, the most significant issue is the reversal of special reserves.

In the insurance industry, the Insurance Act (regulatory law) requires insurance companies to maintain special reserves (e.g. equalisation reserves or catastrophe reserves) to ensure the insurers have capability to meet their obligations in the event of a major loss event or catastrophe. These reserves have been a feature of the regulatory landscape for almost 20 years.

Under IFRS, the special reserves currently maintained by insurance companies are to be reclassified as shareholder equity. The reversal of these reserves will pass through the financial statements of an insurer as accounting income upon the transition to IFRS. As it has been the practice of insurance companies to claim a tax deduction on incremental additions to these reserves, their reversal creates the risk of income that will be subject to taxation. Insurance companies therefore face the prospect of an immediate tax payable of 17% of the value of the special reserves immediately prior to conversion to IFRS.

The tax at stake is expected to be substantial. According to balance sheet

statistics compiled by the Taiwan Insurance Institute for the year 2010, the total special reserves accumulated in domestic insurance companies is approximately NT$145 billion (approx. US$5 billion). Despite the potential for a significant tax exposure, the regulatory authority and tax authority have not yet provided any proposals to address this issue.

Introduction of Luxury Tax

The Specifically Selected Goods and Services Tax Act (also known as "Luxury Tax"), effective from 1 June 2011, was promulgated by the Presidential Office on 4 May 2011. It was introduced with the main aim of curbing real estate speculation, though applies more broadly to a basket of high end goods and rights.

In accordance with the provisions of the Luxury Tax Act, tax at the rate of 10 – 15% of the gross proceeds will be imposed where selected goods and rights are sold within two years of acquisition by a taxpayer. It potentially applies to transfers of:

- Land and buildings;
- Upscale automobiles with taxable values of not less than NT$3 million;
- Yachts with taxable values of not less than NT$3 million;
- Airplanes, helicopters and ultra-light vehicles with taxable values of not less than NT$3 million;
- Turtle shells, hawksbill, coral, ivory, furs, and their products with taxable values of not less than NT$500,000 (excluding those that are not protected species under the Wildlife Conservation Act, or products made from them);
- Furniture with a value exceeding NT$500,000;
- Any membership rights with a selling price of not less than NT$500,000, except when in the nature of a refundable deposit.

As the main purpose of the Luxury Tax is to curb short-term real estate speculation, some exemptions have are provided for transfers which do not have a profit making character. This includes transfers arising upon foreclosure; a testamentary transfer of property, gifts, and the first-time transfers of real property after completion of construction.

In Taiwan, it is commonplace for insurers to invest in real estate. The introduction of Luxury Tax may impact the nature and timing of investment or divestment decisions. As Luxury Tax is imposed on the gross proceeds, insurers should examine whether their disposal of real estate will give rise to Luxury Tax - a divestment that is subject to this tax may result in an overall loss even though the subject property may have increased in value.

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[1]Credit card companies, and insurance agency and brokerage companies are excluded from the requirement to adopt IFRS in 2013, may instead defer and convert until 2015.

Thailand

Are current tax rules sufficiently well made to drive insurance M&A?

It is generally accepted that the financial position of insurance companies operating within Thailand needs to be strengthened in order to ensure the stability of the industry within the country. One of the ways to achieve this objective is through promoting the constructive use of mergers and acquisitions (M&A), especially among small and medium-sized players.

It is arguable that the current taxation regime in Thailand acts as an impediment to the growth of M&A activity within the insurance sector. The purpose of this article is to briefly touch upon those areas of particular concern, and to reiterate the need for the taxation rules to operate in a complementary and enabling fashion to support this broader economic aim.

The need for M&A activity

It is recognised that in order to increase the long-term competitive capability of insurance companies in Thailand, a greater amount of industry consolidation is needed. The Office of the Insurance Commission (OIC) has listed promoting insurance M&A as one of its policy objectives in the Insurance Development Master Plan No. 2 (2010 2014).

One of the mechanisms to drive M&A in the insurance industry was introduced in the second amendment to the Insurance Act in 2008 (which became effective on 1 September 2011). These amendments require insurance companies to maintain statutory reserves which are calculated using the "risk-based capital" framework. Supported by the OIC's regulations, the industry is inevitably being pushed towards M&A, particularly as a more intense capital adequacy requirement will be imposed in coming years.

The move of Thailand towards trade liberalisation within ASEAN, or the ASEAN Economic Community in 2015, is another force. When the time comes, domestic insurance companies will not only need to compete with local insurers, but also with larger and more established operators in the region. Doubtless these will change the direction of the insurance business in Thailand. In order to survive, the capital of the insurance companies—especially for small and medium-sized ones— will need to be raised. M&A is expected to be stimulated as a survival instrument. Combining smaller insurance companies into larger sized businesses brings with it the economies of scale one would ordinarily expect. This includes lower operating costs, easier and faster access to additional capital, and an increase in competitiveness.

The tax environment

One factor discouraging M&A among insurance companies at present is the potential tax burden. There is not currently a specific tax regime governing insurance M&A. The available M&A tax schemes (e.g., for amalgamation, Entire Business Transfer (EBT), or Partial Business Transfer (PBT)), apply to M&A activity in general and are not sufficiently crafted to accommodate the unique circumstances of the insurance industry.

The following are some of the tax related issues which can potentially arise in the case of insurance M&A transactions.

> "One factor discouraging M&A among insurance companies at present is the potential tax burden. There is not currently a specific tax regime governing insurance M&A."

Policy reserves

Under Thai tax law, provisions are generally disallowed as deductible expenses for corporate income tax purposes. An exception is made for life and non-life insurance businesses. Such taxpayers are allowed to treat their reserves as tax-deductible expenses at a rate not exceeding 65% for life insurance and 40% for non-life insurance. As these reserves have never been subject to income tax, a tax on these reserves can be triggered for the first time in the course of an M&A transaction.

Policy reserves are a major component in the accounts of an insurance company. Although the potential tax may be mitigated if there is tax loss or other significant expense in the M&A year, it remains one of the major issues of concern to be managed when it comes to insurance M&A.

“The policy reserve potentially subject to tax was expected to be over Baht 10 billion, which was considered to be a prohibitive and unacceptable cost.”

One cannot overstate the importance of this potential issue as a roadblock to M&A activity. It has recently been reported in the press that a proposed merger between two well-known Thai life insurance companies did not proceed for this very reason. The policy reserve potentially subject to tax was expected to be over Baht 10 billion, which was considered to be a prohibitive and unacceptable cost.

Indirect tax related to the transfer of assets
Capital gains on debt instruments are subject to specific business tax (SBT) in Thailand. None of the current general M&A tax provisions provide an exemption from the SBT that may arise upon the transfer of securities as part of an M&A transaction.

In addition to the risk of SBT applying upon the transfer of securities, both SBT and transfer fees are imposed upon the transfer of immovable property. Although there are exemptions which may potentially apply, these are subject to certain conditions which ought be given due consideration when an M&A transaction is structured. While these amounts may not be significant when compared to the potential tax hit associated with the taxation of policy reserves, it represents another issue which needs to be carefully managed and quantified as a transaction cost.

VAT on the transfer of in-force non-life policies
The provision of non-life insurance services is subject to value added tax (VAT) in Thailand. It is generally accepted that the novation of in-force policies can trigger a liability to VAT. Although VAT is not considered to be the true tax cost because it gives rise to a refundable tax credit, its payment has the potential to impact upon the cash flow position of an acquirer in certain circumstances.

Other issues
In addition to the above, there are also other tax related factors which have the potential to deter M&A among insurance companies. This includes the rules governing the utilisation of carried forward tax losses, access to outstanding tax refunds, and the application of deferred tax assets recognised in the accounts of both parties to a transaction. Generally speaking, these attributes are considered part of the tax profile of each entity and are not allowed to be transferred. Other risks and potential costs can also arise depending upon the particular circumstances of a proposed transaction.

Conclusion

The need for increased consolidation inthe insurance industry might not materialise without a specially crafted tax regime to accommodate the unique circumstances of insurance M&A. Without change, a lack of flexibility in the current tax provisions is likely to continue to create prohibitive tax related transaction costs. A cooperative effort from the Insurance Association, OIC, and the Revenue Department is needed to develop a suitable insurance M&A tax reform package that meets the needs of the insurance industry. It is hoped that all stakeholders will come together to facilitate more M&A activity, and in turn realise the greater stability that is desired by regulators and insurance companies alike.

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Vietnam

Recent tax developments affecting Vietnamese insurers

A number of changes have been made over the past year to the taxation of insurance companies in Vietnam. A new Law on Insurance Business came into effect on 1 April 2011, while a replacement Circular providing specific guidelines on VAT and corporate income tax (CIT) for the insurance sector (Circular 09) became effective on 7 March 2011.

New general guidelines on CIT and VAT are in the drafting process and expected to be issued by the end of 2011. Set out below is a summary of these recent and pending changes, together with an analysis of other issues which are of relevance to insurers operating in Vietnam.

Changes for insurance companies under Circular 09

Due to the specific nature of the insurance business, in addition to the general tax regulations, insurance businesses have to follow detailed guidance only applicable to them. Circular 111/2005 (Circular 111) formerly provided this guidance and has now been replaced by Circular 09.

Below is a summary of major VAT and CIT changes brought about with the introduction of Circular 09.

VAT

Under Circular 09, insurance services are either VAT exempt or subject to 10% VAT depending on the scope of services offered. Circular 09 has added the provision of non-life insurance consultancy and non-life insurance brokerage services to the list of services which are subject to VAT. These services were not included under the previous Circular and Circular 09 therefore clarifies the VAT treatment of these services.

Circular 09 also extends the list of insurance services that are exempt from VAT. Reinsurance in general is now exempt from VAT. Previously, Circular 111 provided only a VAT exemption for overseas reinsurance. In addition, training of insurance agents can now enjoy VAT exemption. From a practical perspective, the training of insurance agents outsourced to third parties will no longer result in a VAT leakage at the level of a life insurance company.

On the other hand, insurance services provided in connection with international transportation are no longer included in the list of exempt insurance services and will attract VAT.

In line with the general VAT regulations, Circular 09 provides a 0% rate of VAT for insurance services provided to enterprises in non-tariff areas, and also to overseas organisations and overseas individuals. In relation to overseas organisations and overseas individuals, the 0% rate of VAT can be applied if the following conditions are fulfilled:

"Circular 09 also extends the list of insurance services that are exempt from VAT. Reinsurance in general is now exempt from VAT."

- The overseas organisation must not have a permanent establishment and must not be a VAT payer in Vietnam.
- The overseas individual must not be a foreigner residing in Vietnam or an overseas Vietnamese or a Vietnamese residing abroad in the period for which the services are provided.

Circular 09 also clarifies that insurance broking enterprises shall not have to pay VAT on brokerage commissions where the underlying insurance services are not subject to VAT. In addition, life insurance companies shall not have to pay VAT on proceeds from the disposal of assets used for life insurance activities.

CIT

Circular 09 stipulates that insurance companies are subject to the general CIT rules, but also provides specific guidelines in relation to the determination of turnover and deductible expenses for insurance activities.

One change brought about by the introduction of Circular 09 is the determination of turnover. Circular 09 no longer refers to turnover from financial activities, and only refers to turnover from insurance business activities and insurance broking activities. It is unclear why Circular 09 excludes the turnover from financial activities. One explanation could be that such turnover is already covered under the general CIT regulations and therefore specific reference in Circular 09 is no longer required.

Circular 09 has removed several deduction items specifically mentioned under old Circular 111 and now mentions only a number of specific expenses which are tax deductible. However, the deductibility of expenses of an insurance company needs to be determined based on the general deductibility criteria set out under the prevailing CIT regulations. It is possible that items that were removed under Circular 09 may still be deductible under the general criteria.

Other recent changes relevant to insurance companies

New rules on profit repatriation
For foreign insurance companies with subsidiaries in Vietnam, the new regulations regarding profit repatriation (effective from January 2011) may be of interest. Foreign investors are permitted to remit their profits only annually at the end of the financial year or upon termination of their investment in Vietnam. Provisional profit distributions, which were allowed under the old regulations, are no longer an option.

The previously required tax clearance has been replaced with a notification process. Taxpayers must notify the tax authorities of the proposed profit remittance within 7 working days before payment. Approval from the tax authorities is no longer required.

More focus on transfer pricing
Since the introduction of detailed transfer pricing regulations in 2006, there has been an increased focus on this area by the tax authorities and significant coverage of transfer pricing issues in the media.

A new transfer pricing Circular was issued in April 2010 and since this time the tax authorities have been active in information gathering, requesting retrospective disclosure of related party transactions and reviewing transfer pricing documentation. More recently, the tax authorities have sent questionnaires to taxpayers aimed at gathering industry related information. This could be used for a number of difference purposes including the refinement of transfer pricing legislation, to develop an information database, or to target particular areas that the tax authorities consider to be of concern.

So far, only a limited number of detailed transfer pricing audits have been carried out. However, it is expected that a lot more transfer pricing audits will be carried out by the tax authorities over the next few years. Training of tax officials is currently underway to prepare the manpower needed for this task. The tax authorities have indicated that the focus of such transfer pricing audits will not only be large, loss making multinational companies, but also on domestically owned companies and/or profit making companies with fluctuating margins.

Even though insurance companies may currently not be specifically targeted, insurance companies should be aware of the transfer pricing regulations and prepare their transfer pricing documentation for related party transactions in order to defend their position in a later tax audit.

> “Foreign investors are permitted to remit their profits only annually at the end of the financial year or upon termination of their investment in Vietnam. Provisional profit distributions, which were allowed under the old regulations, are no longer an option.”

Increased focus on compliance with Vietnam Accounting System
All reporting entities operating in Vietnam must prepare their accounting records in compliance with Vietnam Accounting System (VAS). This includes the use of local currency and language, and a prescribed chart of accounts. However, such requirements may not always be fully compatible with international accounting systems.
In the past, the application of VAS has not been strictly enforced but in recent tax audits, this has become an area of specific focus.

A lack of full VAS compliance can have potentially significant consequences, such as denial of tax deductions, VAT input tax credits or tax incentives. Therefore, all companies operating in Vietnam should pay attention to this issue and evaluate their VAS compliance status.

Fiscal stimulus measures 2011 not applicable to insurance business
In order to bolster the Vietnam economy in the current global climate, small and medium enterprises (SMEs) are entitled to a one year deferral of their 2011 CIT payment. The 2010 deferred CIT amounts that are due in 2011 are also eligible for an additional nine month deferral in 2011. However, SMEs being insurers are not entitled to the CIT payment deferral.

There is a draft decree providing for a 30% reduction in 2011 CIT for SMEs and labour intensive enterprises engaged in certain areas. However, insurance businesses are again not eligible for this reduction.

Proposed tax reforms 2012

New guidelines on CIT, VAT and Special Sales Tax are in the drafting process and expected to be issued by the end of 2011 and effective from 1 January 2012. The changes are aimed at rectifying certain limitations of existing legislation.

They also seek to address issues that various industry sectors have lobbied for, and to introduce Government tax policy changes.

Proposed changes in CIT
The proposed changes include favourable amendments to the CIT deductibility provisions including a full deduction for life insurance premiums for employees (subject to documentation requirements). This change will impact the insurance business in a positive way since more companies in Vietnam may be willing to buy life insurance for their employees.

Other proposed changes, may have little or no relevance for insurance companies.

Proposed changes in foreign contractor withholding tax
Vietnam's foreign contractor withholding tax (FCWT) regime is a collection mechanism for CIT and VAT on payments to foreign companies, e.g. interest, royalties, licence fees, management fees and head office charges. As part of the proposed tax reforms, the Government is looking to amend certain provisions relating to the CIT element of FCWT.

The proposed changes to CIT rates to be applied under the FCWT regime, in so far as they are likely to affect insurers, are as follows:

	Current	Proposed
Interest	10%	5%
Reinsurance	2%	0.1%

"The proposed changes include favourable amendments to the CIT deductibility provisions including a full deduction for life insurance premiums for employees (subject to documentation requirements)."

The reduction of the withholding tax rate for reinsurance is a positive step, even though most of the foreign reinsurers are able to claim a CIT exemption under a double tax treaty. The reduction of the interest withholding tax rate from 10% to 5% is also an appreciated change for Vietnamese businesses, but may (depending upon their capital structure) have only little impact on insurers.

The current draft version of the changes do not include transitional or grandfathering provisions, but past FCWT reforms suggest that these may be forthcoming when more detailed guidance is issued.

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