The implications of IFRS for Old Basis Business

Part 26/ Chapter 1

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Executive Summary

The “I-E” (or income less expenses) tax computation in respect of old basis business is based on investment return (i.e. Case III, Case IV, Case V and Chargeable Gains) as opposed to trading profits. The investment return is apportioned between policyholders and shareholders; the policyholders’ share being taxed at a corporation tax rate equal to the standard rate of income tax (20%) and the shareholders’ share being taxed at the standard rate of corporation tax (12.5%). As the I-E computation is based on investment return as opposed to trading profits, it is largely unaffected by the change to IFRS.

However, the following issues arise.

1.1 Notional Case I

Relief is allowable to a life assurance company for management expenses, but this is subject to the limitation that the tax borne by a company after the allowance of management expenses must not be less than would have been payable if the profits of the company had been charged to tax under Case 1 of Schedule D - this is referred to as the Notional Case 1. The starting point for the Notional Case I computation of an assurance company is the transfer to shareholders of surplus per the return to the Financial Regulator. However, s.710(1) TCA 1997 provides for the exclusion from the charge to tax of any amounts reserved for policyholders. In practice, any surplus not transferred to shareholders in the regulatory returns is treated as reserved for policyholders. Given that the amount of the surplus transferred to shareholders is based on the transfer per the return to the Financial Regulator and that the return to the Regulator is unaffected by the change to IFRS, the notional case 1 computation should continue to be prepared on the same basis as before.

1.2 Accounting for Insurance Contracts as Investment Contracts

Where, under IFRS, certain unit-linked and similar contracts are treated as investment contracts, so that they are not accounted for in the Income Statement but, rather, as balance sheet items, the old basis I-E Computation is unaffected. The I-E computation should continue to be based on an unchanged understanding of what constitutes investment income, chargeable gains and expenses.

1.3 Valuation Issues

There may be instances in which "fair value" under IFRS does not equal market value under Irish GAAP. For example, IFRS may require a bid price valuation whereas

existing Irish GAAP would use a mid price valuation. This will give rise to a prior year adjustment on the changeover to IFRS. S.719 TCA 1997 deems life assurance companies to dispose, at the end of each accounting period, of all old basis assets at "market value" and immediately reacquire them, also at market value. S.720 then taxes any deemed gain under CGT rules over seven years. Companies have in the past used the "market value" per the accounts to calculate this deemed gain. Once IFRS is introduced, it is possible that companies will wish to use "fair value" per IFRS accounts and this may differ slightly from "market value" under current Irish GAAP.

In cases where a particular arrangement is already in place to give effect to the provisions of s.719 and s.720, the position post-IFRS must be tax neutral in that nothing should fall out of charge or be doubly taxed as a result of the change to IFRS. This must be achieved by ensuring that the first computation of gains post-IFRS is based on opening values of the assets concerned which are the same as the closing market values of those assets which were used to compute unrealised gains for tax purposes directly before the move to IFRS. This will give effect to the requirement of s.719(2) that the assets concerned are **deemed to be disposed of and immediately reacquired** at the same value.