

# “Excessive Reserving” Test for Tax on UK General Insurers?

November 2009

## Introduction

In July 2009, HM Revenue and Customs (“HMRC”) released new Regulations to limit the amount of tax relief available on the technical provisions of general insurers which came into force on 1 September 2009, to apply to accounting periods ending on or after 31 December 2009.

The relevant tax legislation is Schedule 11 to the Finance Act 2007 – Technical Provisions made by General Insurers (“The Legislation”). The associated regulations – The General Insurers’ Technical Provisions (Appropriate Amount) (Tax) Regulations 2009 SI2009/1926 (“the Regulations”) are now available on [www.opsi.gov.uk](http://www.opsi.gov.uk).

## Summary

The aim of the Legislation and Regulations is to specify an **“appropriate amount”** of technical provisions for a general insurance company which may potentially limit the tax relief available for tax purposes. The UK government are concerned that insurers may be reserving too prudently for tax purposes, although we believe that HMRC expect very few insurers to have clearly excessive reserve strength.

An actuarial opinion supported by an actuary or a suitably skilled person is required to demonstrate that the technical provisions in the accounts are both adequate and not excessive.

If HMRC challenged the insurer’s tax return and the insurer does not provide a suitable opinion, then the default basis for the claims reserves that will be allowable for tax purposes will be the undiscounted best estimate.

In line with the other regulations and legislations in the UK, they are principle based rules and are open to interpretation. This briefing aims to provide a high level summary of our interpretation of the Regulations.



## Who is affected?

The regulations will apply to all UK general insurers including:

- Lloyd’s general insurance syndicates;
- UK branches of non-UK general insurance companies;
- Captive insurers with UK domiciled parents (likely to be Controlled Foreign Companies).

## Timing of the regulations

In relation to a general insurer, the regulations shall have effect in relation to accounting periods ending on or after 31/12/09. To a member of a Lloyd’s syndicate, they shall have effect in relation to a syndicate return made in respect of profits or losses declared after 31/12/09.

## Definition of the Appropriate Amount

The “appropriate amount” of the technical provisions in the accounts is defined as the sum of:

- The unearned premiums reserve (UPR);
- The unexpired risks reserve (URR); and
- The claims outstanding provision\* (including incurred but not reported and incurred but not enough reported) – net of reinsurance basis and may include claims handling expenses.

\*The claims outstanding provision within the appropriate amount can only be included if the following conditions are satisfied:

- i) The general insurer gives confirmation in writing that the outstanding claims provision is not excessive (“**The Confirmation**”), and
  - ii) The Confirmation is founded on or supported by an opinion (“**The Actuarial Opinion**”) in writing given to the general insurer by an actuary or other suitably skilled person.
- B. The Actuarial Opinion must reflect the circumstances prevailing at the time at which the technical provisions are adopted by the general insurer.
- C. The amount of the liabilities is determined in accordance with all technical actuarial standards published by the Board for Actuarial Standards (or the equivalent in respect of non-UK general insurers).

If the above conditions are not met, then the appropriate amount in respect of the claims outstanding will be the general insurer’s undiscounted best estimate.

Please note that the Confirmation and Actuarial Opinion are only required in relation to the claims outstanding provision. No Confirmation or Opinion is required for UPR and URR. However, these amounts must be calculated in accordance with the relevant accounts and regulations.

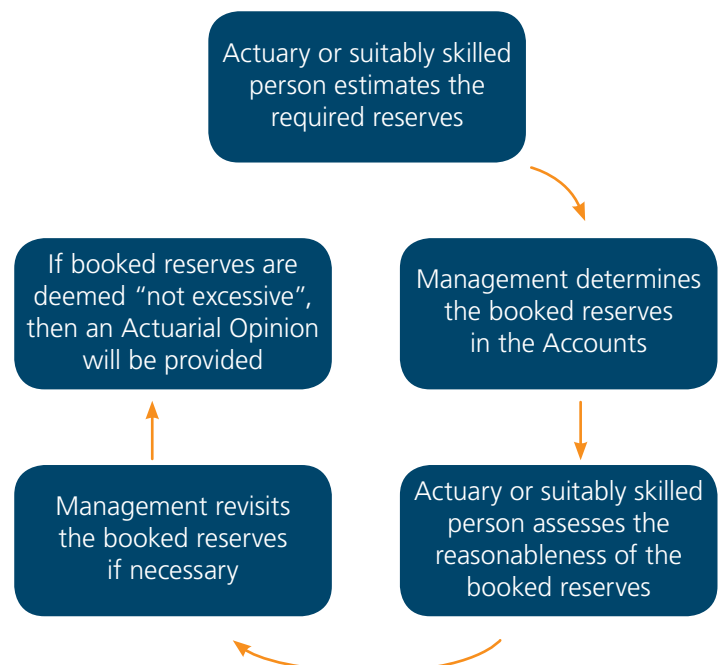
## Timing of Confirmation and Opinion submission

The Confirmation must be provided to HMRC along with the tax return, but the Actuarial Opinion does not necessarily need to be provided. However, the Confirmation must be founded on or supported by the Actuarial Opinion given to the insurer. Hence, the Opinion must be signed on or before the date of the Confirmation. HMRC guidance suggests that providing additional information such as the Actuarial Opinion is beneficial to the risk assessment process.

Although the filing deadline for the tax return is one year after the accounting date for a general insurer and six months for Lloyd’s syndicates, we recommend that this analysis should be carried out at the time the financial statements are finalised. We would expect the directors of the company would like to know whether the outstanding claims provision is likely to be excessive or not, especially when it may have an impact on the company’s tax position.

## Process

We envisage the process will involve the following main steps:





## How will HMRC identify insurers for investigation?

As mentioned previously, we believe that HMRC expect only very few insurers will have 'clearly' excessive reserve strength and will cause them concern.

HMRC plan to use a two tier approach to conduct their risk assessment. First is to use a quantitative test to identify possible 'outliers' compared to industry norms. We understand that HMRC plans to use industry data which differentiates the company market, non-UK captive insurance companies and Lloyd's syndicates. The exact details will be published by HMRC in due course.

The second element of the risk assessment approach involves identification of 'risk factors' which might warrant further investigation. Examples of the risk factors could be:

- Use of the undiscounted best estimate instead of providing an Actuarial Opinion;
- The person providing the Actuarial Opinion, i.e. external consultant, an employee or Director of the company;
- How much information was supplied to HMRC to support the Actuarial Opinion;
- Other general information such as reserving history of the insurers;
- The level of tax at risk.

The current guideline suggests that enquiries are likely to be considered if the insurer is flagged as an outlier in the quantitative test.

## Issues

Based on the definition of the appropriate amount, we have highlighted a few main issues which may be of interest to the insurers:

**Actuarial Opinion** – The Opinion must be an actuarial one, even if the person is not an actuary, i.e. a suitably skilled person. This person can be an employee or Director of the company or external to the company. If the person is employed by the company, a statement confirming the status of the person giving the Opinion must be included in the Confirmation.

In addition, the format of the Opinion is not provided by HMRC. However, we understand that a suggested wording may be provided by HMRC in their guidance notes in the future.

**Actuarial Standards** – The Regulations state that the calculations and analysis carried out in support of the Actuarial Opinion must comply with all the generic and relevant technical actuarial standards published by the Board for Actuarial Standards. This applies even if the person providing the Opinion is not an actuary.

**Definition of "excessive"** – The Regulations state that an estimate is excessive unless it includes "no more than a reasonable margin to take into account the nature or type of risk to which the liabilities relate and the uncertainty associated with those risks". As there is no further clarification of the term "reasonable", we believe this definition of excessive becomes highly judgemental and it is down to the actuary or other suitably skilled person.

**Discounting** – HMRC appear to be leaving it to the insurer to determine whether discounting is appropriate for part or all of its reserves. The insurer will need to exercise its own judgement in this area.

**Alternative provision amount** – The insurer may provide an alternative reserve figure for tax purpose if supported by a suitable Actuarial Opinion that the accounts provision is recognised to be excessive.

## Further information

If you would like more information on anything in this briefing please contact your usual Barnett Waddingham contact or one of the following General Insurance specialists:

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