Paper 2

Treatment under HKFRS 17 of the Premium-Based Profit Tax (PBPT) applicable to life insurance entities authorized to issue life insurance contracts in Hong Kong (Deloitte)

Background

The PBPT is a tax that applies only to life insurance entities authorized to issue life insurance contracts in Hong Kong. During 2019-22, an extensive discussion has unfolded that has resulted in a fundamental reassessment of the nature of the PBPT under HKFRS.

The emerging practice from this discussion is that the historical conclusion of considering the PBPT as an income tax under the scope of HKAS 12 has been challenged and some entities may conclude it would not be in the scope of that standard because they would view it as a revenue tax instead.

The classification of the PBPT as a revenue tax would classify the resulting amounts as an expense amount that is not included in the income tax expense line of the statement of comprehensive income.

The question discussed in this paper is whether the PBPT should be considered part of the HKFRS 17 fulfilment cash flows when the entity concludes that it is outside the scope of HKAS 12.

The same question when the PBPT is in the scope of HKAS 12 has already been discussed in the meeting of the former Insurance Implementation Support Group (now Insurance Advisory Panel) on 26 April 2019. The paper and the meeting summary are attached in the appendix of this document.

Issue

When the PBPT is judged to be outside the scope of HKAS 12 should it be included in the fulfilment cash flows of a group of insurance contracts under HKFRS 17?

View 1 - Yes

HKFRS 17:33 mandates that an entity includes in the fulfilment cash flows of a group of insurance contracts all the future cash flows that are within the contract boundary. HKFRS 17:2 stipulates that "an entity shall consider its substantive rights and obligations, whether they arise from a contract, law or regulation, when applying HKFRS 17."

In addition, HKFRS 17:B65 states that the "cash flows within the boundary of an insurance contract are those that relate directly to the fulfilment of the contract".

Finally, HKFRS 17:B65(i) indicates that fulfilment cash flows include "transaction-based taxes (such as premium taxes, value added taxes and goods and services taxes) and levies (such as fire service levies and guarantee fund assessments) that arise directly from existing insurance contracts, or that can be attributed to them on a reasonable and consistent basis."

The body of requirements quoted above supports the conclusion that the PBPT, when considered a tax outside the scope of HKAS 12, should be included in the HKFRS 17 fulfilment cash flows of a group of contracts.

This conclusion rests on the fact that the nature of the PBPT when judged outside the scope of HKAS 12 is similar to that of a transaction based tax described in B65(i) because the premiums from the group of contracts is the only dimension considered in the calculation of the PBPT. While this is calculated at the entity level rather at the individual contract level, it can be attributed to the contracts on a reasonable and consistent basis.

View 2 - No

Supporters of this view argue that the PBPT cannot be part of the fulfilment cash flows of a group of contracts because it is not attributable to the fulfilment of the obligations under the contracts. They note that there is sufficient evidence for this conclusion and that this applies to both outcomes of the judgment on the nature of the PBPT and its placement in the scope or HKAS 12 or outside its scope.

The first argument in support to View 2 is that the rights and obligations under the contract do not change when the entity irrevocably elects to abandon the PBPT in favour for the ordinary income tax regime applicable to life insurance in Hong Kong. This ordinary income tax regime is based on actuarial surplus calculations. This fact indicates that the PBPT is effectively a transaction that applies to the entity as a whole and it would not be logical to attribute it to the insurance contracts it issues only. In this context, supporters of view 2 also point to the fact that if a HK entity subject to PBPT has losses from another business, (non-life insurance business in same taxable entity as life insurance business) either in the current year or brought forward, those losses can be used to offset the profits calculated for life insurance business. Supporters of view 2 see this as evidence of the fact that the nature of the PBPT is not a "transaction based tax (…) that arise directly from existing insurance contracts, or that can be attributed to them on a reasonable and consistent basis". Rather, the ability to offset profits under PBPT with losses from other businesses suggests instead that the nature of the tax is at level of the entity and it is not a transaction-based tax.

The second reason is derived from HKFRS 17:B66(f) that mandates to exclude the "income tax payments and receipts the insurer does not pay or receive in a fiduciary capacity or that are not specifically chargeable to the policyholder under the terms of the contract". There are not Hong Kong contracts that call out the PBPT as one that the policyholder has to pay. The PBPT is one of two possible taxation regimes that a life insurer can choose for issuing life insurance contracts in Hong Kong and its contractual rights and obligations are unaffected by the choice. Equally, when the choice is made, the laws and regulations in Hong Kong do not require the event to be communicated to the policyholder nor it is an observed practice for life insurer to do so on a voluntary basis. This conclusion is equally applicable to the PBPT under the scope of HKAS 12 and by analogy when judged to be outside HKAS 12.

The third reason is to reject the conclusion of View 1 supporters that the PBPT judged to be outside HKAS 12 is a transaction based tax covered by HKFRS 17:B65(i) because for the PBPT to be a transaction-based tax it should be known to the consumer. On the contrary, as explained above, the consumer is not aware and its rights and obligations are unaffected by the choice made by the insurer to use the PBPT or to elect the taxation under the actuarial surplus. Supporters of View 2 argue that such taxes as are intended to be covered by IFRS 17.B65(i) are clearly visible in the economics of a transaction and the attribution to the insurance contract is a permanent judgment that is not dependent on the entity's discretion as it would be for the PBPT. They believe that it is equally appropriate to rebut the argument of a transaction-based tax that is "attributed to them [the contracts] on a reasonable and consistent basis" because the allocation would not be justified when the entity elects to move from the PBPT to the actuarial surplus taxation thus making the attribution one that uses an inconsistent basis.

Paper 2

Appendix

Agenda paper 4 discussed at the IISG meeting held on 26 April 2019

Paper 4.pdf

https://www.hkicpa.org.hk/-/media/HKICPA-Website/New-HKICPA/Standards-and-regulation/SSD/06_New-and-major-stds/hkfrs-17/2019-Agenda-papers-and-meeting-summaries/0426/Paper-4.pdf

Summary of the meeting (refer to pages 3-4)

04ms.pdf

https://www.hkicpa.org.hk/-/media/HKICPA-Website/New-HKICPA/Standards-and-regulation/SSD/06_New-and-major-stds/hkfrs-17/2019-Agenda-papers-and-meeting-summaries/0426/04ms.pdf