

Accounting for taxes
considering the
impact of IFRS 17 –
What insurers need
to know now



Building a better
working world

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Executive summary

What are the things to consider for insurer?

The implementation of IFRS 17 on or after 1 January 2023 is the most significant change in reporting of financial statements for insurers in the past decade.

Taxes may have an effect on the measurement of the insurance liabilities under IFRS 17. The implementation of the IFRS 17 standard, however, has also implications on the calculation of current and deferred taxes.

Some direct and indirect tax cash flows are in the scope of the IFRS 17 measurement model and play a role when determining the fulfilment cash flows to assess the IFRS 17 technical assets and liabilities. The type of applicable taxes varies significantly across jurisdictions and must be analyzed on a local country basis. When implementing the requirements, insurers should consider both technical and operational aspects.

Additionally, current and deferred income taxes of insurers are significantly affected by the new concept of accounting for insurance contracts. Multinational groups may find that implementation of the new standard has different impacts on their tax accounting in different territories.

In tax regimes where taxable profits are calculated based upon an accounting profit calculated in accordance with IFRS, the adoption of the new standard will have current tax consequences. The same applies in jurisdictions with a local GAAP basis which is aligned to IFRS and the tax authorities will adopt IFRS 17. This will also be the case where the tax regime specifies the basis for calculating taxable profits, and that tax base invokes IFRS or an IFRS-aligned local GAAP as the measurement basis for items whose accounting treatment will be impacted by IFRS 17.

In cases where taxation is not based on the IFRS profit, deferred taxes will arise on the valuation difference between IFRS 17 accounting and local tax accounts.

It should be noted that in some countries, taxable profits may be calculated based upon an accounting profit calculated in accordance with either IFRS or local GAAP. Where those bases diverge on the introduction of IFRS 17, different entities in the same country may be taxed on different bases, depending upon the GAAP adopted.

EY teams are supporting insurers by considering the impacts of IFRS 17 on their income tax accounting. We see tax involvement in the following stages of the IFRS 17 financial reporting process.

- ▶ IFRS 17 measurement models
- ▶ IFRS 17 tax accounting
- ▶ Future local tax reporting
- ▶ Future group tax reporting
- ▶ Opening balance adjustments

To recognize the IFRS 17 impact on the reporting process, insurers must analyze the respective tax impact on each stage for their company and adjust their operating model regarding policies, processes, people, and data and systems:

- ▶ Adjusting group policies, data and systems with regard to tax reporting and tax accounting requirements under IFRS 17 and expected future tax payments for IFRS 17 measurement models
- ▶ Alignment of manual and automatic processes for income tax reporting taking potential tax impacts from local tax regimes into account
- ▶ Integration of tax in IFRS 17 projects and reporting process by creating awareness from internal stakeholders
- ▶ Training of tax, finance and accounting teams

When multinational groups adopt IFRS 17 in their group tax reporting process, they need to find a balance between a standardized group-wide approach and considering different tax impacts for their local business units.

1

IFRS 17 measurement models

According to the IFRS 17 standards, tax cash flows must be taken into account when determining the fulfilment cash flows to assess the IFRS 17 assets and liabilities:

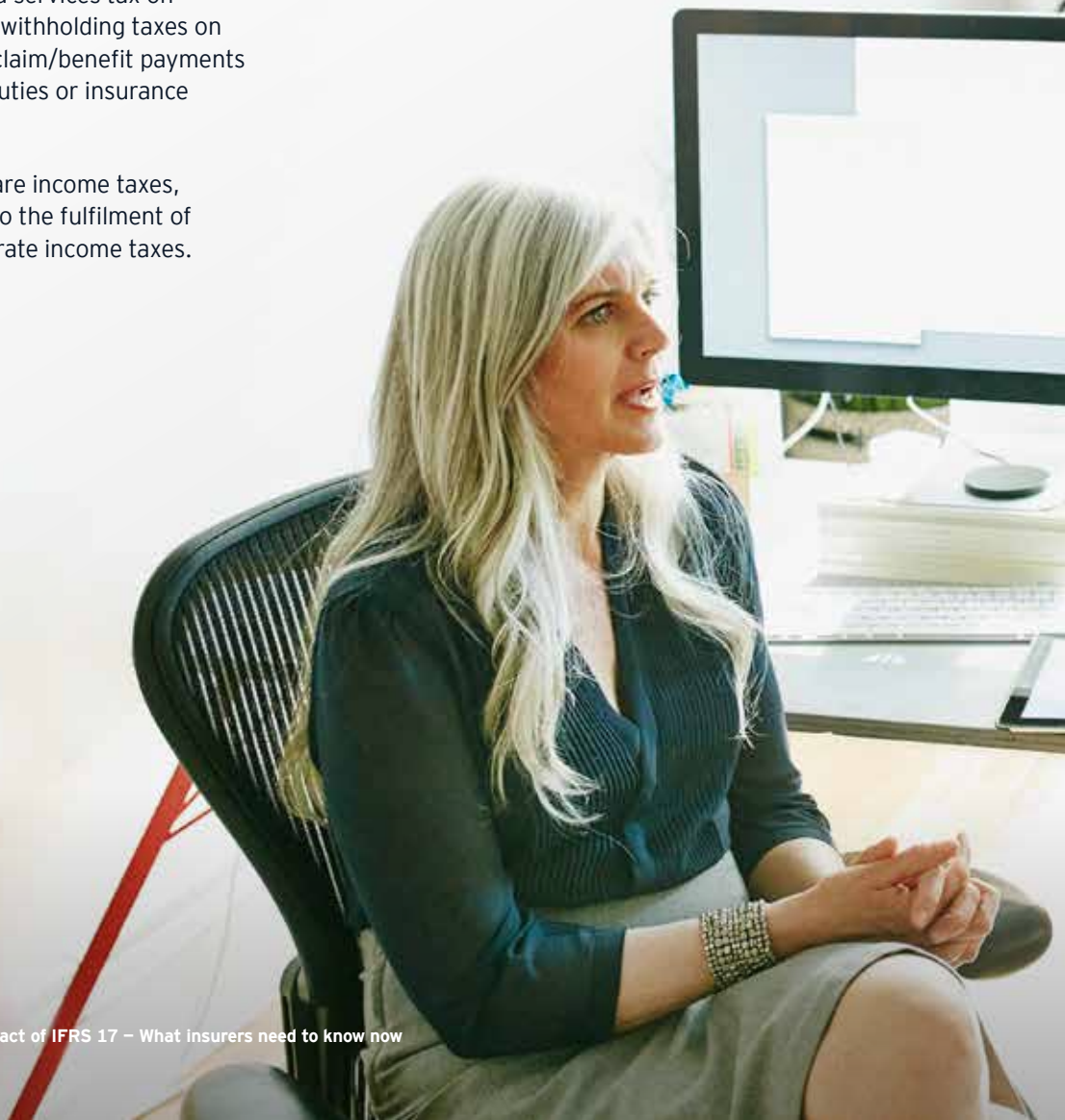
- ▶ Transaction-based taxes and levies that arise directly from existing insurance contracts or can be attributed to the insurance contracts on a reasonable and consistent basis (IFRS 17.B65 (i))
- ▶ Payments by the insurer in a fiduciary capacity to meet tax obligations incurred by the policyholder, and related receipts (IFRS 17.B65 (j))
- ▶ Income tax specifically chargeable to the policyholder under the terms of the contract (IFRS 17.B65 (m))

Tax cash flows to consider in this regard may be, among others, value-added tax or goods and services tax on premiums, commissions and claims, withholding taxes on outbound reinsurance payments or claim/benefit payments or other local levies such as stamp duties or insurance premium levies.

Explicitly excluded in the standards are income taxes, that cannot be directly attributable to the fulfilment of an insurance contract such as corporate income taxes.

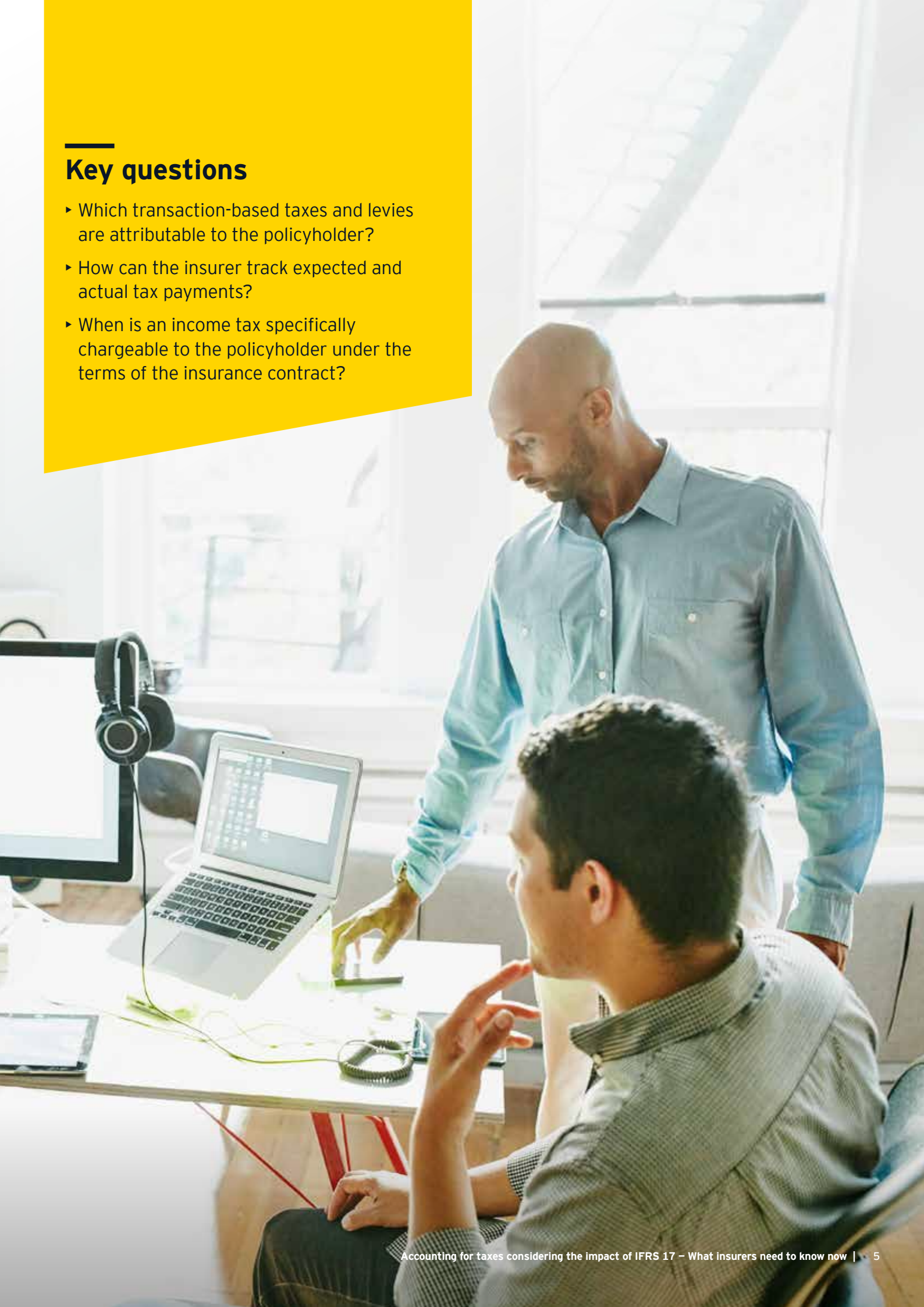
The mentioned applicable taxes are dependent on the definition of the local tax jurisdiction and may vary significantly across countries and between different types of business. Insurers need to perform detailed analysis based on the nature of the specific tax charge and the related policy terms (e.g., whether the tax payments are in a fiduciary capacity or income taxes that are specifically chargeable to the policyholder).

Difficulties may arise in allocating certain taxes e.g., unrecoverable indirect taxes to the respective cash flows. For pass-through taxes, the impact on the financial statements arises solely from timing difference between the receipt and the payment of the tax, and may be immaterial in certain cases.



Key questions

- ▶ Which transaction-based taxes and levies are attributable to the policyholder?
- ▶ How can the insurer track expected and actual tax payments?
- ▶ When is an income tax specifically chargeable to the policyholder under the terms of the insurance contract?



2

Future local tax reporting

IFRS 17 only refers to certain tax cash flows that are included in the Fulfilment Cash Flows (FCFs) but does not contain specific requirements regarding the income tax positions of an insurer itself.

Therefore, the principles and requirements of the applicable IFRS tax standard (IAS 12) continue to apply after the effective date of IFRS 17. This applies to “all domestic and foreign taxes which are based on taxable profits.”¹ The tax expense/tax income comprises current tax expenses (current tax income) and deferred tax expenses (deferred tax income).²

Current taxes are calculated based on the taxable profit or loss determined by the tax laws (substantially) enacted by local tax authorities. Where taxable profits or losses are calculated based upon an accounting profit calculated in accordance with IFRS, the adoption of the new standard will have current tax consequences. Current (cash) tax impacts may arise for those insurers operating in countries like e.g., the UK, Canada, Singapore or Australia having adopted IFRS 17 for their account as the calculation of the current tax is based on the accounting profit prepared under IFRS. IFRS 17 will have an immediate effect on the current income taxes and the local tax return process.

Insurers may currently face significant uncertainty in determining the taxable income for the calculation of current taxes. In most countries, the tax regime position may not be known in sufficient detail so that in formulating accounting systems and policies, insurers may have to take a view. But presumably the expectation is that there will be clarity before IFRS 17 becomes effective.

Most tax authorities are still consulting with the industry on potential alignment of tax, regulatory and statutory reporting standards.

Key topics that are still under discussion in some territories include the IFRS 17 insurance liabilities are recognized in full for tax purposes, the tax treatment of the Contractual Service Margin (CSM) and any timing differences regarding the recognition of profitable vs. onerous contracts.

For entities where the adoption of IFRS 17 will have a current tax impact, there will be:

- ▶ A transitional impact from the adjustment to opening retained earnings or other comprehensive income (OCI) on implementation; plus
- ▶ An ongoing impact on periodic tax calculations

To limit the impact of IFRS 17 on current tax payments, in a number of countries there are discussions about the possibility of spreading any transitional tax effects over a certain time period. The discussions about the applicable time period differ between the countries and the applicable insurance line of business. In Canada, for example, discussions on this point have been moving toward five years for general insurance and ten years for life insurance linked to the average policy duration. Similar timelines have been proposed by the insurance industry in the UK to the tax authorities to recognize a spread of 10 years. Final timelines are still outstanding.

The industry also needs to account for any uncertain tax positions arising from the transition adjustments and new potential tax law changes.

To align with IFRS reporting processes, new tax law changes need to be substantially enacted by 1 January 2023. Otherwise, the local tax filing basis remains as enacted by local tax law, and separate accounting records for local statutory and tax reporting purposes need to be maintained.

The adoption of IFRS 17 as a tax filing basis may lead to significant adjustments of the current income tax calculation process. The precise implementation will be determined by the rules set by the local tax legislator and may differ from country to country. Therefore, insurers need to monitor the legislation process in the operating countries closely and consider the tax implications of IFRS 17 on the current income taxes at a single country level.

¹ IAS 12.2

² IAS 12.6

Key questions

- ▶ Will IFRS 17 be adopted in the operating countries as the tax filing basis for current income taxes?
- ▶ Is there already any discussion by the legislator or fiscal authorities and if yes, what is the direction of travel and if so, should the company or group engage in the discussion?
- ▶ Do uncertain tax positions arising from transition adjustments and the ongoing treatment of new items under IFRS 17 need to be considered?



3

Impact of IFRS 17 on the accounting for income tax under IAS 12

Deferred taxes are the amounts of income taxes payable or recoverable in future periods based on taxable, or deductible temporary differences, or unused tax losses or credits carried forward.³

Temporary differences arise as a result of differences between the carrying amount of an asset or liability in the balance sheet and its local tax base.⁴

For tax reporting purposes, the restatement of IFRS 17 insurance assets and insurance liabilities leads to impacts on the recognition of deferred taxes. Companies applying IFRS 17 need to adjust their tax reporting processes and calculation of deferred taxes to comply with IAS 12.

In financial statements prepared under IFRS 17, temporary differences may change as a result of the restatement of insurance assets and insurance liabilities, while the corresponding local tax base does not change. The new accounting model for insurance contracts therefore affects the temporary difference between the carrying amount of IFRS 17 balance sheet positions and the corresponding local tax base. A technical analysis is necessary to determine the allocation of IFRS 17 accounts to the corresponding tax base.

The reassessment of temporary differences is determined by several considerations:

- ▶ **Recognition of building blocks:** The carrying amount of insurance assets and liabilities must be examined in their separate building blocks like Future Cash Flows, Time Value for Money, Risk Adjustments and Contractual Service Margin and compared to the corresponding tax base. A similar process should be applied where an insurer uses the premium allocation approach, following the amounts recognized under the premium allocation approach.

- ▶ **Determination of taxable or deductible temporary differences:** The reassessment of temporary differences from IFRS 4 accounting to IFRS 17 requires reassessing whether or not the temporary differences result in an obligation to pay income taxes in future periods in case of a taxable temporary differences or can be utilized against taxable profit in future profits in case of deductible temporary differences.
- ▶ **Taxes on income presented outside profit or loss:** When income items are recognized outside profit or loss because of accounting policy choices such as the OCI option on insurance finance income/expense, insurers must consider to what extent potential current and deferred tax consequences should also be presented in other comprehensive income.

The determination of temporary differences may differ from country to country given different local tax laws and therefore each analysis needs to consider country specific differences.

Deferred tax assets are only recognized to the extent that they are recoverable.⁵ This is the case when it is probable that sufficient taxable profit will be available which enables the utilization of the DTA.

Sources of expected taxable profit need to be reassessed considering potential changes through IFRS 17 to determine the recoverability of DTAs.

Insurers will need to implement the results of the technical analysis within their tax reporting processes and tax systems. Tax reporting tools may need to be amended based on the technical analysis. Usually the comparison between IFRS and tax base is done on account level, thus the mapping for tax reporting on account level needs to be amended to a new IFRS 17 chart of account.

³ IAS 12.15, IAS. 12.24

⁴ IAS 12.5

⁵ IAS 12.56

Key questions

- ▶ Which temporary differences arise from the transition and how are they treated?
- ▶ How is the carrying amount of the insurance asset or liability to be mapped to the local corresponding tax base?



4 Group tax reporting

In terms of consolidation group tax reporting, the set up and execution of a group-wide consistent approach considering local differences between accounting regimes adopted IFRS 17 and other countries applying a tax base other than IFRS 17 is a challenge.

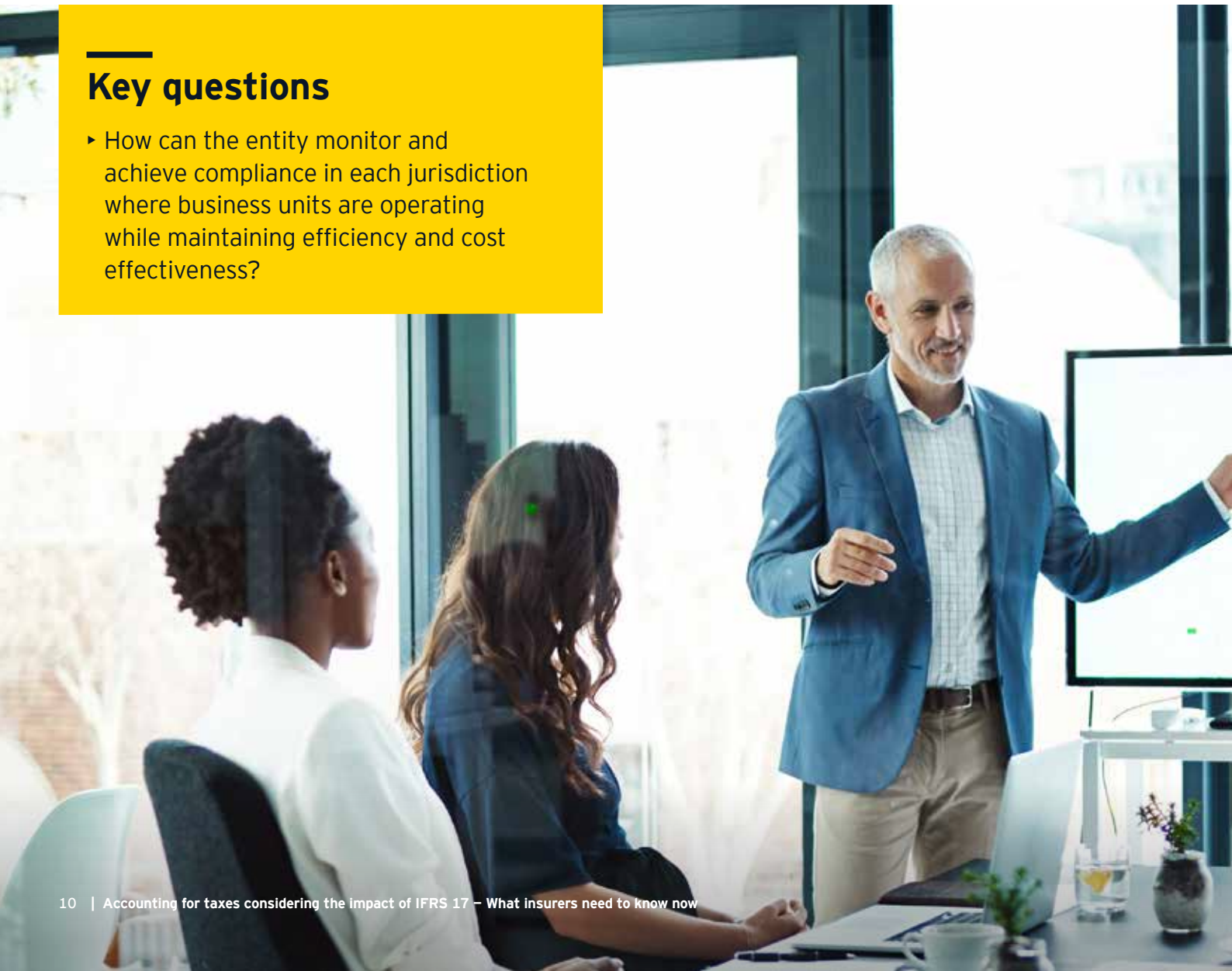
Compliant and consistent tax accounting methodologies must be developed and adopted for all jurisdictional levels to ensure

that temporary differences referring to the respective local tax base are identified and recorded properly at local level which can be cross-referenced for group tax reporting purpose.

IFRS 17 transition adjustments may affect on the reconciliation of the group's effective tax rate including different taxation regimes and determining potential uncertain tax positions on the group's financial statement.

Key questions

- ▶ How can the entity monitor and achieve compliance in each jurisdiction where business units are operating while maintaining efficiency and cost effectiveness?



5

Opening balance adjustments

Potential differences between IFRS 17 and IFRS 4 opening balance sheet on the IFRS 17 transition date can lead to changes in the amount of deferred tax assets or liabilities. These transition adjustments must be considered in the opening balance sheet adjustments for implementation and comparative period.

Most insurers apply the temporary exemption from applying IFRS 9 for periods prior to 1 January 2023 and will implement

both standards IFRS 9 and IFRS 17 for their 2023 financial statements. However, IFRS 9⁶, includes an exception from the requirement to restate comparatives whereas IFRS 17⁷ requires the restatement of 2022 comparative information. If insurers choose to restate comparatives for IFRS 17 only, mismatches may occur between financial assets and insurance liabilities. Such mismatches will also come with a tax effect that should be considered for the 2022 comparatives.

Key questions

- What is the impact of the transition adjustments on current taxes and/or deferred taxes?

⁶ IFRS 9.7.2.15

⁷ IFRS 17.C2(b)

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