June 2021

Tax update

Tax implications of Risk-Based Capital “(RBC)” 2 framework

Executive summary

The new RBC framework “(RBC 2 framework)” took effect from 31 March 2020. Notwithstanding the changes to the regulatory framework, the Comptroller of Income Tax “(CIT)” will generally maintain the existing tax treatment for insurers.

This alert discusses the tax treatment of the above changes under RBC 2 framework which have an impact on taxation taking effect in the Year of Assessment “(YA)” 2021.

EY

Building a better working world

Background

The Inland Revenue Authority of Singapore "(IRAS)" has issued an e-tax Guide "Income Tax: Taxation of Insurers Arising from Changes Made to Risk-Based Capital Framework" on 14 August 2020.

The above e-tax Guide discusses the following three changes under the RBC 2 framework which have an impact on taxation:

- One-off revaluation of policy liabilities of insurance business arising from the transition to the RBC 2 Framework
- Amount of policy liabilities as computed under the RBC 2 framework
- De-recognition of reinsurance arrangements with foreign head office

Subsequently, the IRAS has updated the above e-tax Guide on 1 February 2021 to make the following amendments in Annex A of the e-Tax Guide:

- Amended paragraphs 1, 3 and 4 to clarify that the additional allocation to the surplus account (i.e. $1/9^{th}$ of the tax payable on the allocation of the par fund to policyholders) will be disclosed and subject to tax separately, with effect from YA 2021.
- Replace Form Annex A2-4 of the Monetary Authority of Singapore "(MAS)" returns with the amended Form Annex A2-4 which has an additional row 6 for "Amount arising from tax payable on allocation by way of bonus to the participating policies".

This alert discusses the tax treatment of the above changes.

One-off revaluation of policy liabilities of insurance business arising from the transition to the RBC 2 framework

When the RBC 2 framework was first applied on 31 March 2020, insurers would have had to perform a one-off revaluation of their policy liabilities. Any difference between the carrying amount of policy liabilities as at 30 March 2020 and the remeasured policy liabilities as at 31 March 2020 under the RBC 2 framework would be included in Form A3 row 5 of the MAS returns as "Retrospective restatement to beginning balance", net of tax.

For tax purposes, the one-off revaluation, gross of tax, would be deductible or taxable where the revaluation results in an increase or decrease in the policy liabilities respectively. An illustrative example is provided in Annex B of the e-tax Guide. Based on the illustration, the amount of policy liabilities to be deductible or taxable should be computed based on the summation of the following (using 31 December 2020 financial year end for illustrative purposes):

- Difference between 1 January 2020 and 30 March 2020
- One-time revaluation on 31 March 2020 (gross of tax)
- Difference between 31 March 2020 and 31 December 2020

It appears that no further tax adjustment is required for the deductible or taxable policy liabilities (including the one-off revaluation) if the difference in policy liabilities between 1 January 2020 and 31 December 2020 is equal to the above three components. Based on our observations, the total net movement above is also included in the "increase/(decrease) in policy liabilities" in profit and loss accounts of the financial statements.

Amount of policy liabilities as computed under the RBC 2 framework

The existing tax treatment of accepting the amount of policy liabilities as computed in accordance with the regulatory framework will continue to apply. An increase in policy liabilities will continue to be allowed for tax deduction, while a decrease in policy liabilities will be taxed without any tax adjustments.

De-recognition of Reinsurance Arrangements with a Foreign Head Office

With effect from 1 January 2022, MAS may de-recognize reinsurance arrangements between a Head Office and its branch in Singapore. If so, more policy liabilities will be allowed as a deduction whilst the reinsurance premiums for reinsurance ceded to the Head Office will not be deductible, and the reinsurance recovery and commission income from the Head Office will not be taxable.

Tax treatment on the additional allocation to the surplus account

This change applies only for insurers with participating policies. With effect from 31 March 2020, a life insurer may make an additional allocation to the surplus account under Regulation 22(4)(c) of the Insurance (Valuation and Capital) Regulations. This additional allocation refers to an amount that does not exceed $1/9^{th}$ of the amount of tax payable at

the tax rate of 10% on the total amount allocated to policyholders. The additional allocation will be reflected as "amount arising from tax payable on allocation by way of bonus to the participating policies" in row 6 of Annex A2-4 of the MAS Return.

For tax purposes, with effect from the YA 2021, the above additional allocation reflected in row 6 of Annex A2-4 will be part of the gains or profits of the shareholders of the participating fund and subject to tax in the hands of the shareholders of the participating fund. The additional allocation will not be subject to any tax adjustments and no expenses, capital allowances or donations will be allocated for deduction against this amount. Please refer to Appendix A for an illustrative example.

Appendix A: Illustrative example to compute the taxable surplus of the participating fund

Assuming the distributions by a participating fund to policyholders and shareholders for a relevant financial year is as follows (per MAS Returns):

Form L9 of MAS Returns

Description	Row No.	Singapore Insurance Fund
Bonus payments made to policy owners in anticipation of allocation	1	600
Allocation to policy owners:		
Cash bonus	2	100
Reversionary bonus	3	100
Terminal bonus	4	100
Total amount to policy owners (1 to 4)	5	900
Allocation to surplus account	6	100

Annex A2-4 of MAS Returns

Description	Row No.	Singapore Insurance Fund
Allocation to surplus account	1	100
Surplus account investment revenue	2	40
Less:		
Surplus account investment expenses	3	0
Surplus account investment income (2 - 3)	4	40
Recovery of amount transferred out of surplus account if it has not been transferred back into surplus account previously	5	0
Amount arising from tax payable on allocation by way of bonus to the participating policies	6	10 *
Less:		
Amount transferred from surplus account to satisfy minimum condition liability	7	0
Others	8	0
Net Income (1 + 4 + 5 + 6 - 7 - 8) = Row 25 of Form A2	9	150

** An amount up to 1/9th of the tax payable on allocation of surplus to policyholders = $900 x 10% tax rate x 1/9*

For tax purposes, the taxable surplus of the participating fund will be computed as follows:

	Amount (S$)
Allocation to surplus account (Row 6 of Form L9 / Row 1 of Annex A2-4)	100
Add: Allocation to policyholders (Row 5 of Form L9)	900
Total distribution	1,000
Add/(less): Non-deductible expense / (Non-taxable income)	(200)
Taxable surplus	800

	Policyholders (S$)	Shareholders (S$)	Total (S$)
Taxable surplus	720	80	800
Add: Investment income from surplus account (Row 4 of Annex A2-4)[1]	-	40	40
Add: Additional allocation to surplus account (Row 6 of Annex A2-4)	-	10	10
	720	130	850

[1] The above should include the necessary tax adjustments relating to non-deductible/non-taxable items included in the surplus account investment income. In this example, it is assumed that such tax adjustment is NIL.

If you would like to know more about EY services or the issues discussed, please contact one of the following or your usual EY contact:

Stephen Bruce
Partner, ASEAN FSO Tax Leader, Ernst & Young Solutions LLP
+65 6309 8898
stephen.bruce@sg.ey.com

Adrian Halter
Partner, Financial Services Tax, Ernst & Young Solutions LLP
+65 6309 8778
adrian.halter@sg.ey.com

May Tay
Director, Financial Services Tax, EY Corporate Advisors Pte. Ltd.
+65 6505 2410
may.tay@sg.ey.com

Leow Yuet Yong
Associate Director, Financial Services Tax, EY Corporate Advisors Pte. Ltd.
+65 6309 8564
yuet-yong.leow@sg.ey.com

Quek Ruoting
Associate Director, Financial Services Tax, EY Corporate Advisors Pte. Ltd.
+65 6309 8521
ruoting.quek@sg.ey.com

Kuek Li Wen
Senior Manager, Financial Services Tax, EY Corporate Advisors Pte. Ltd.
+65 6309 6102
li-wen.kuek@sg.ey.com

Michelle Phua
Manager, Financial Services Tax, EY Corporate Advisors Pte. Ltd.
+65 6309 6181
michelle.phua@sg.ey.com

Soh Shen Mei
Manager, Financial Services Tax, EY Corporate Advisors Pte. Ltd.
+65 6340 2039
shen-mei.soh@sg.ey.com

Our tax leaders in Singapore

Ernst & Young Solutions LLP

Head of Tax
Soh Pui Ming
Email: pui.ming.soh@sg.ey.com

Business Tax Services
Choo Eng Chuan
Email: eng.chuan.choo@sg.ey.com

Global Compliance and Reporting
Chai Wai Fook
Email: wai-fook.chai@sg.ey.com

Financial Services Organisation
Stephen Bruce
Email: stephen.bruce@sg.ey.com

Indirect Tax Services
Yeo Kai Eng
Email: kai.eng.yeo@sg.ey.com

People Advisory Services
Panneer Selvam
Email: panneer.selvam@sg.ey.com

International Tax and Transaction Services

International Corporate Tax Advisory
Chester Wee
Email: chester.wee@sg.ey.com

Transfer Pricing
Luis Coronado
Email: luis.coronado@sg.ey.com

Transaction Tax Advisory
Darryl Kinneally
Email: darryl.kinneally@sg.ey.com

Legal Services
(provided by Atlas Asia Law Corporation,
an independent member firm of the global EY network)
Evelyn Ang
Atlas Asia Law Corporation
Email: evelyn.ang@atlasasialaw.com.sg

EY | Building a better working world

EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. EY member firms do not practice law where prohibited by local laws. For more information about our organization, please visit ey.com.

© 2021 EYGM Limited.

All Rights Reserved.

ED None

EYG no. 005316-21Gbl

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, legal or other professional advice. Please refer to your advisors for specific advice.

ey.com