Tax Reporting Conference

Taxation impact of IFRS 17 – Insurance Contracts

Unraveling the impact of the implementation of IFRS 17 for the profit tax reporting

Curaçao – November 9, 2023

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Agenda

I. Introduction

II. IFRS 17 – Insurance Contracts

III. Transition to IFRS 17

IV. Measurement models IFRS 17

V. IFRS 4 vs IFRS 17

VI. Taxation comparison of IFRS 17

- Principles for determining the taxable profit of insurance contracts
- Accounting principles for insurance contracts (IFRS 17)
- Comparison taxation principles and accounting principles for insurance contracts
- New concept for insurance revenue

VII. Implications of IFRS for the tax reporting

VIII. Further remarks

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I. Introduction

Our Speakers

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Our Moderator

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Head of the Tax Department

II. IFRS 17 – Insurance contracts

An official international IFRS Standard for insurance contracts.

IFRS 17 – Insurance Contracts

Definition of insurance contracts

A contract under which one party (the issuer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

The key components :

1. Compensation for a specified uncertain future event
2. Policyholder adversely affected by the insured event
3. Significant transfer of insurance risk to the insurer.

IFRS does not apply to insurers but to insurance contracts. It is possible that certain contracts of an insurance company do not fall under IFRS 17 and, also that non-insurers must apply IFRS 17 for contracts that qualify as insurance contracts.

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IFRS 17 – Insurance contracts

Objectives of IFRS 17

IFRS 17 replaces the IFRS 4 standard and is designated to provide consistent and transparent accounting guidelines for insurance contracts.

The primary objectives of IFRS 17 are:

I. To provide a single, comprehensive accounting model for all types of insurance contracts.

II. To enhance the transparency and comparability of financial statements for insurance companies.

III. To ensure that the measurement of insurance contracts is based on current market conditions, reflecting the time value of money.

IV. Provide users of the financial statements with the information required to meaningfully understand the insurer's financial position, performance and risk exposure.

V. Align insurance contracts accounting with general IFRS accounting of other industries.

III. Transition to IFRS 17

The transition from IFRS 4 to IFRS 17

IFRS 17 – Transition

Methods of transition

Full Retrospective Approach: involves restating an insurance company's financial statements as if IFRS 17 had been applied from the beginning of the earliest period presented.

Modified Retrospective Approach with the Use of the CSM: applies IFRS 17 only to the current period and future periods, without restating financial statements from prior years.

Fair Value Approach: involves measuring insurance contracts at fair value from the transition date onward. It does not use the CSM. This method is typically used for contracts that have little or no remaining coverage.

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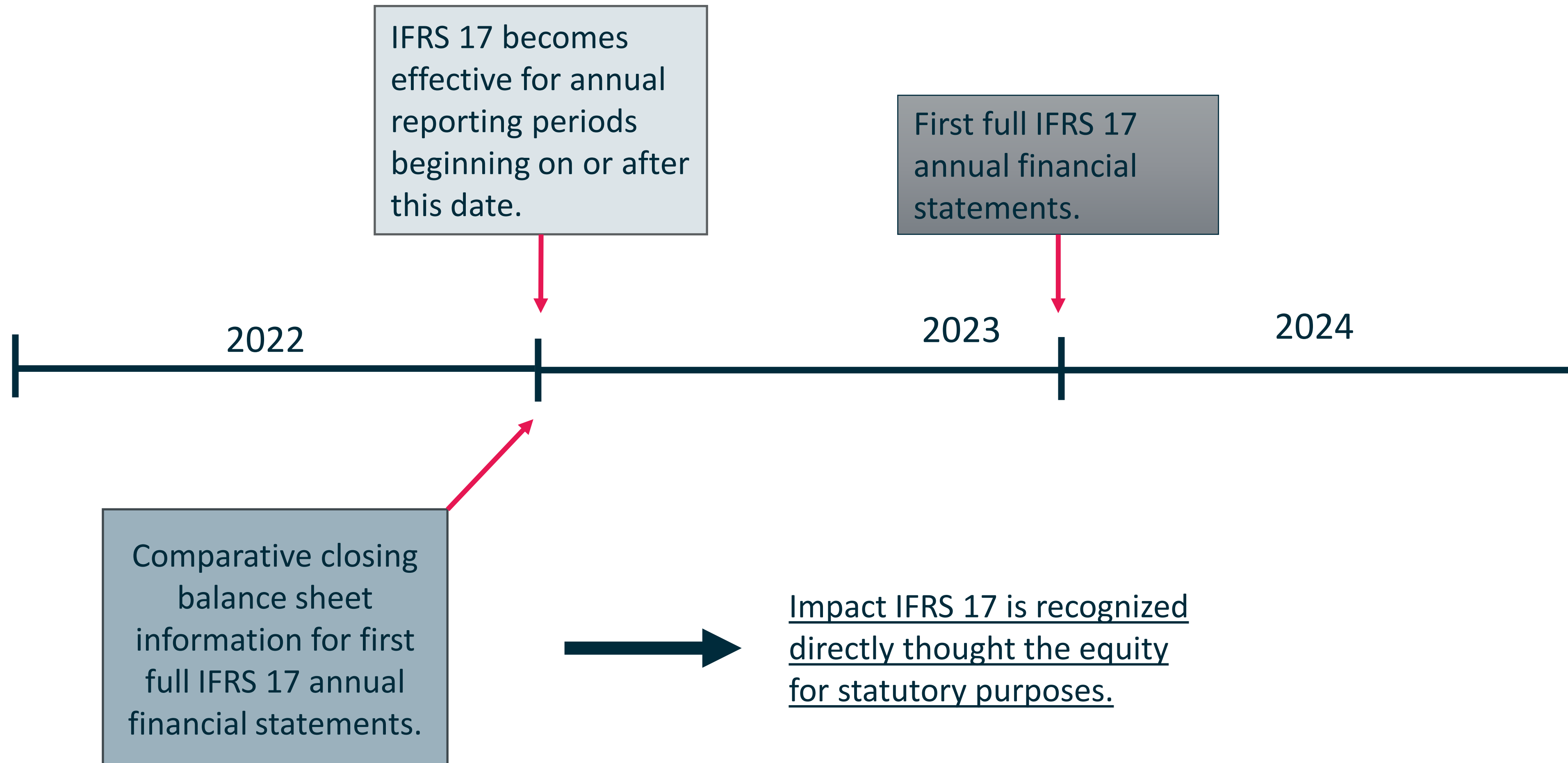
IFRS 17 – Transition



**Financial year in this example is equal to the calendar year*

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IV. Measurement models IFRS 17

An explanation of the various valuation methods that IFRS 17 has in order to understand the tax implications of each method

IFRS 17 – Measurement Models

I. General Measurement Model (GMM or "Building Block Approach")

The GMM is the primary measurement model used for insurance contracts under IFRS 17. The GMM should be applied to all insurance contracts, unless they have direct participation features and the contract in in de scope of the Variable Fee Approach .

II. Premium Allocation Approach (PAA)

The Premium Allocation Approach is an alternative measurement of the liability for remaining coverage for insurance contracts under IFRS 17, that can be used if the insurer meets the eligibility criteria.

III. Variable Fee Approach (VFA)

The VFA is used for insurance contracts with direct participation features (DPF). The VFA considers both insurance and investment components.

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IFRS 17 – Measurement Models

Valuation of the carrying amount of the insurance contract liability (or asset)

	Insurance asset or liability	
Measurement models under IFRS 17	**Liability for remaining coverage (LRC)**	**Liability for incurred claims (LIC)**
General Measurement Model (GMM)	Fulfillment cash flows Present value of future cash flows (cash flows; discount rate) + Risk adjustment. Contractual Service Margin (CSM)	Fulfillment cash flows: Present value of future cash flows (cash flows; discount rate) + Risk adjustment.
Premium Allocation Approach (PAA)	Simplified measurement based on unearned premiums.	Fulfillment cash flows: Cash flows (in principle no discounting) + Risk adjustment.
Variable Fee Approach (VFA)	Same as GMM whereas the CSM includes the changes in the variable fee.	Same as GMM

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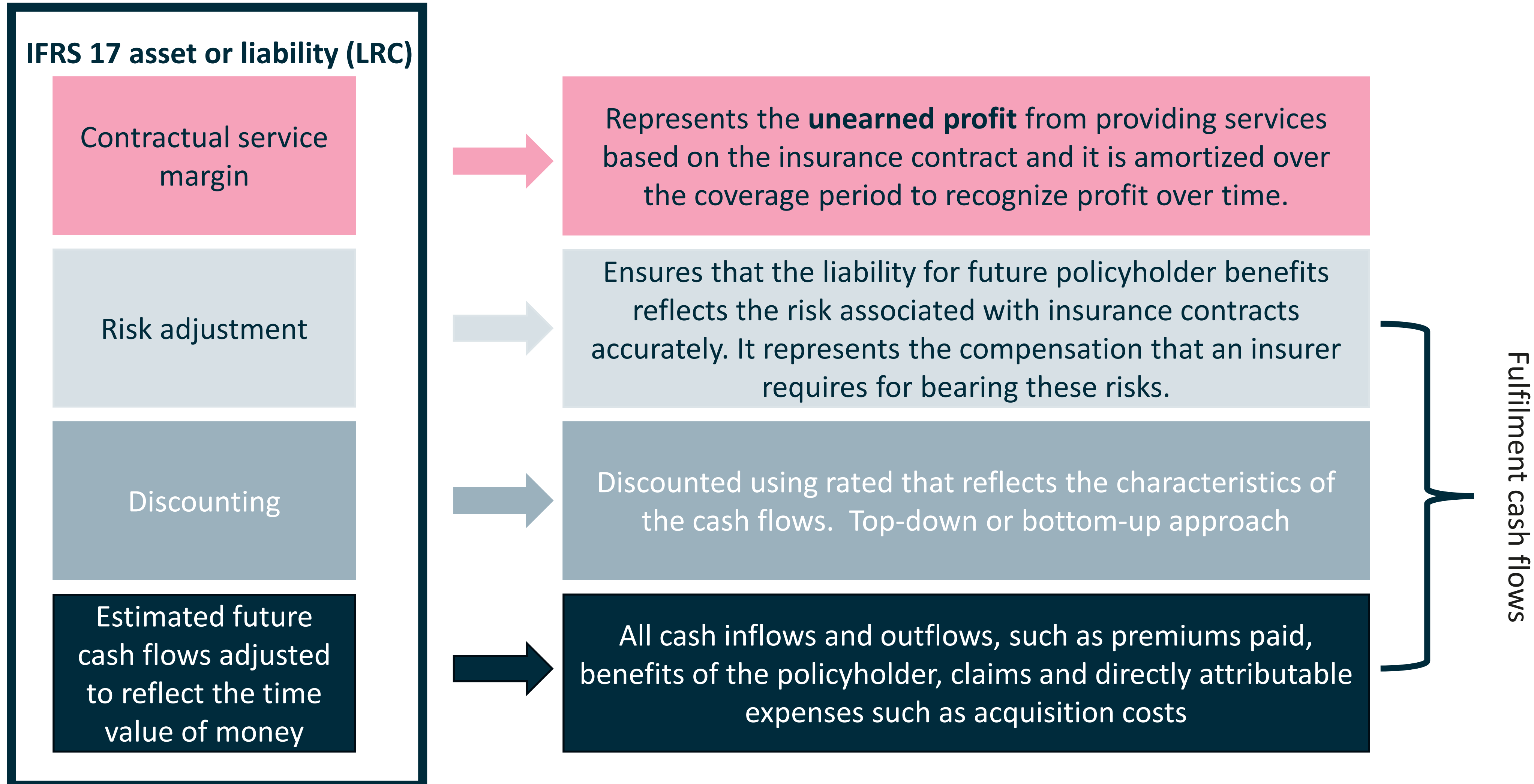
IFRS 17 – Measurement Models

General Measurement Model (Building Block Approach)



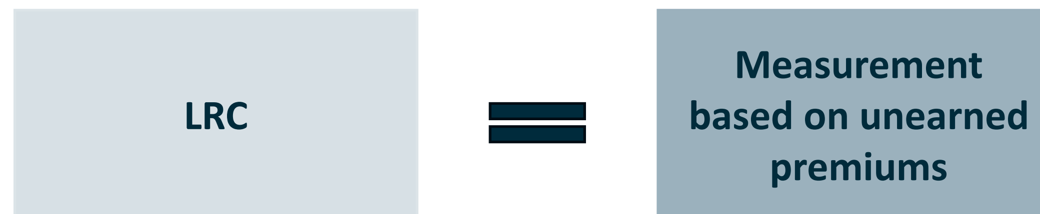
IFRS 17 – Measurement Models

Premium Allocation Approach (PAA)

The PAA is a simplified method for the calculation of the LRC

Eligibility criteria:

- The coverage period of each contract is the group is one year or less
- The LRC calculated under the PAA is not materially different from the LRC calculated under the GMM or VFA



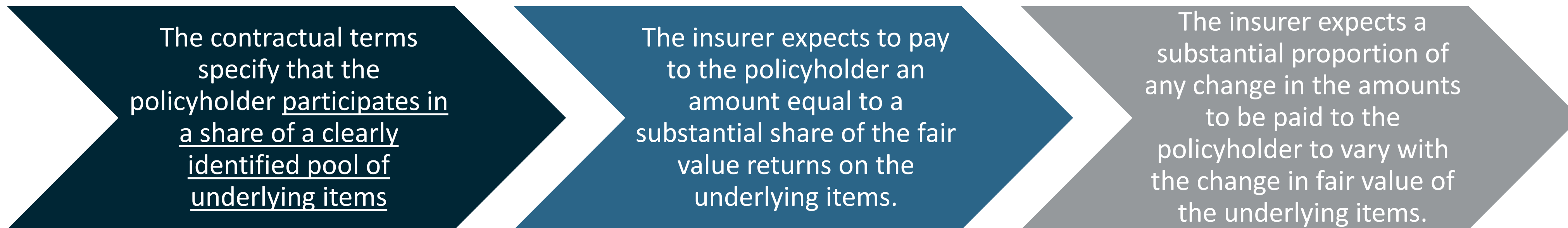
If eligible PAA is optional. If the insurer does not adopt the PAA measurement model or is not eligible to do so, the GMM or VFA should be used for the valuation of the insurance contract.

IFRS 17 – Measurement Models

Variable Fee Approach (VFA)

The VFA is the measurement approach for direct participating insurance contracts

Eligibility criteria for applying the VFA



IFRS 17 requires an entity to apply the VFA to insurance contracts with direct participation features that meet the eligibility criteria.

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V. IFRS 4 vs IFRS 17

Changes to the guidelines regarding recognition and measurement of Insurance Contracts

IFRS 4 – Insurance Contracts

- Introduced in 2004
- Limit changes to the existing insurance accounting practices.
- No specific requirements concerning most aspects of the accounting for insurance contracts.
- Allowed: use of different accounting policies to measure similar insurance contracts in different countries.
- Features of the accounting models used: are inconsistent with the IFRS standards applied by other industries in the same country:
  - limiting comparisons with other industry sectors.

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IFRS 17 – Insurance Contracts

- As of January 1, 2023
- One accounting model for all insurance **contracts** in all IFRS jurisdictions:
  - One consistent framework
- More useful and more transparent information.
- Removes existing inconsistencies:
  - enabling investors, analysts and others to meaningfully **compare** companies, contracts and industries.
- Ensures that an entity provides relevant information that faithfully represents the insurance contracts.
- Enables users of financial statements to assess the effect that insurance contracts have on the entity's financial position, financial performance and cash flows.
- Provides for the achievement of consistent measurement with current market information when possible.
- Requires the entity to recognize gains as the entity satisfies its obligation to provide services over the coverage period.
- Measures solvency at a point in time.

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IFRS 4 vs IFRS 17

IFRS 4	IFRS 17
Consistency in application of accounting treatments of insurance contracts concerning revenue recognition and liability valuation	
Insurers can determine their own methodology.	One consistent framework for the accounting of insurance contracts (applicable for non-insurers when the contract qualifies as an insurance contract).
Use of a wide range of insurance accounting practices based on local accounting requirements (some of which may have been applied prior to implementing IFRS Standards) or variations of those requirements for reporting on a key aspect of their business.	Improves the transparency of the accounting policies applied by companies and enables investors to better analyze the profitability of insurance contracts.
Insurers could offset losses on onerous contracts against profitable contracts.	Requires information to be tracked at the level of group of contracts, according to both their expected profitability at inception and the time at which they were written.

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IFRS 4 vs IFRS 17

IFRS 4	IFRS 17
Consistency in application of accounting treatments of insurance contracts concerning revenue recognition and liability valuation	
Insurers may recognize the expected profits from a group of contracts at inception if there are no restrictions.	The recognition of profit arising from an insurance contract is spread over the period of coverage, this is achieved by the inclusion of the CSM.
Absence of consistent principles for all aspects of accounting for insurance contracts.	Reinsurance contracts held are valued separately from the underlying insurance contracts. Investment are accounted for as financial instruments under IFRS 9 (not as insurance contracts).
Lack of comparability.	Removes existing inconsistencies enabling investors, analysts and others to meaningfully compare companies, contracts and industries.

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VI. Taxation comparison of IFRS 17

Taxation implications of the components of IFRS concerning the insurance contract liability

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Principles for determining the taxable profit of insurance contracts

Principles for determining the taxable profit

For taxation purposes two taxable profits are identified:

1) Total (lifecycle) profit (*totaal winst*): the amount of the jointly obtained benefits, under whatever name and in whichever form, derived from the business;

2) Annual profit (*jaarwinst*): the annual profit is determined in accordance with a consistent practice (*bestendige gedragslijn*) that is independent of the expected outcome.

Therefore, for taxation purposes:

- Balance sheet items are valued based on their condition as of the balance sheet date.
  - Based on knowledge that was known or reasonably could have been known at the time of preparing the balance sheet for taxation purposes.
- The consistent practice is only changed if justified by the principles of sound business practice.
- The business economic standards are considered for determining the taxable profit, unless these are not in accordance with the **principles of sound business practice**.

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Annual profit for taxation purposes

The **annual profit for taxation purposes** (*fiscale jaarwinst*) is determined based on the principles of sound business practice.

Main objective of the calculation of the taxable profit (taxable annual profit) is to subject to the levy of profit tax the **total profit** earned by the enterprise during the period in which the enterprise is a source of income.

Based on:

- **Balance sheet continuity**: the opening balance for taxation purposes reconciles with the closing balance for taxation purposes of the previous year;
- **Error theory (*foutenleer*)**: determines how the requirement for a correct profit determination system relates to the principle of balance sheet continuity:
  - Principle of proper taxable profit determination (*juiste stelsel van winstbepaling*);
  - Principle of balance sheet continuity.

Principle of balance sheet continuity

General rule: An adjustment of the opening balance sheet (opening figures) is in principle **not** in accordance with the principle of balance sheet continuity (therefore reversed/not followed for taxation purposes);

- For statutory purposes: capital adjustment in the adjustment year;
- For taxation purposes: adjustment is recognized through the calculation of the profit for taxation purposes.
  - *Some exceptions apply (capital contribution, capital repayment, dividend, withdrawals etc.).*

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Principles of sound business practice

Three main principles:

1) Realization principle (*realisatiebeginsel*: revenue recognition);
2) Principle of prudence (*voorzichtigheidsbeginsel*);
3) Principle of simplicity (*eenvoudsbeginsel).*

General rules:

- Benefits are subject to tax when they have actually arisen and are realized;
- (uncertain) losses are recognized as soon as it is probable that they will occur.

Realization principle

The realization principle: combined application of the causality principle (*veroorzakingsbeginsel*) and the principle of prudence (*voorzichtigheidsbeginsel*)

> **Principle of prudence** takes precedence over allocation to previous periods **through the causality principle**.

Basic principles:

a) **Principle of causality**: Benefits are subject to tax when they have actually arisen and are realized (*veroorzaking*);

b) **Principle of prudence**: Losses are recognized as soon as it is probable that they will occur, even if they are not yet certain (*voorzichtigheid*);

c) **Matching principle**: Revenues are attributed to the same period as the expenses they are related to.

Objective:

- Determine the annual taxable profit in accordance with the economic reality;
- Prevent arbitrary profit shifting.

Principle of prudence

Principle of prudence within the principles of sound business practice:

1) Part of the realization principle

   - Profits are recognized upon realization and losses when they are probable.

2) By itself

   - Losses are recognized at the time of identification/probability rather than at realization.

     - Certain degree of certainty that the (future) losses will actually occur.

Principle of simplicity

General rules:

- The calculation of the taxable annual profit is **not** unnecessarily complicated beyond what is necessary for the nature and size of the enterprise;
- Manageability of the applied method for the calculation of the taxable annual profit.

Generally, the principle of simplicity would allow for the application of general accepted accounting standards and principles for statutory purposes to be followed/considered for the calculation of the taxable annual profit.

General conclusion principles sound business practice

- The total (lifecycle) profit for taxation purposes is allocated to calendar years in accordance with the principles of sound business practice;
- Basis is the business economic standards, unless these are not in accordance with the principles of sound business practice;
- The taxable annual profit is determined in accordance with the application of the sound business practice:
  - interaction between the realization principle, the principle of prudence, and the principle of simplicity.
  - Considering the balance sheet continuity and error theory.

Sound business practice for insurance contracts (1)

- Insurance contracts: Provision for insurance liabilities
- Identifiable provisions for insurance liabilities for taxation purposes:
  - Premium reserve (to allocate received premiums to the period in which insurance services related to these premiums are performed);
  - Provision for insurance claims (LIC)/Technical provision (to provide for future expected insurance claims): The amount that should be reserved on the balance sheet date to meet all obligations to policyholders.
- The benefits and expenses arising from an insurance contract are allocated as much as possible to the year in which the insurer has provided the services under that contract.
- Future price adjustments are generally neglected:
  - Costs and expenses related to future salary and price changes shall only be taken into account in the year in which these changes actually occur;
  - Exception: insurance contracts concerning the health of natural persons.

Sound business practice for insurance contracts (2)

- Acquisition costs: charged directly through the taxable profit (for life insurance: capitalized and depreciated as the insurance services are provided).

- Administration, collection and disbursement costs: charged directly through the taxable profit (under certain circumstances a provision for expected costs could be entered into the balance sheet for taxation purposes).
  - The costs are based on facts and circumstances that occurred in the period preceding the balance sheet date;
  - are attributable to that period; and
  - reasonable level of certainty that the costs will occur.

- **Profit recognition from insurance contracts:** difference between received premiums and movement in premium reserve and provision for insurance claims.

Accounting principles for insurance contracts (IFRS 17)

IFRS 17 – Accounting principles

- Principle based accounting standards;
- General objective: *improving the comparability of companies on an international scale by providing a **'true and fair view'** of the financial position*.
  - Emphasis: fair value accounting and performance reporting aimed at shareholders.
  - Financial position, financial performance and cash flows;
  - Useful for making economic decisions.
- Focus of the general accounting framework:
  - Relevance/Useful;
  - True and fair view (faithful representation);
  - Understandable;
  - Comparable.
- Principles:
  - Accrual basis of accounting (*toerekeningsbeginsel*)
  - Ability to continue as a going concern (*continuïteitsbeginsel*).

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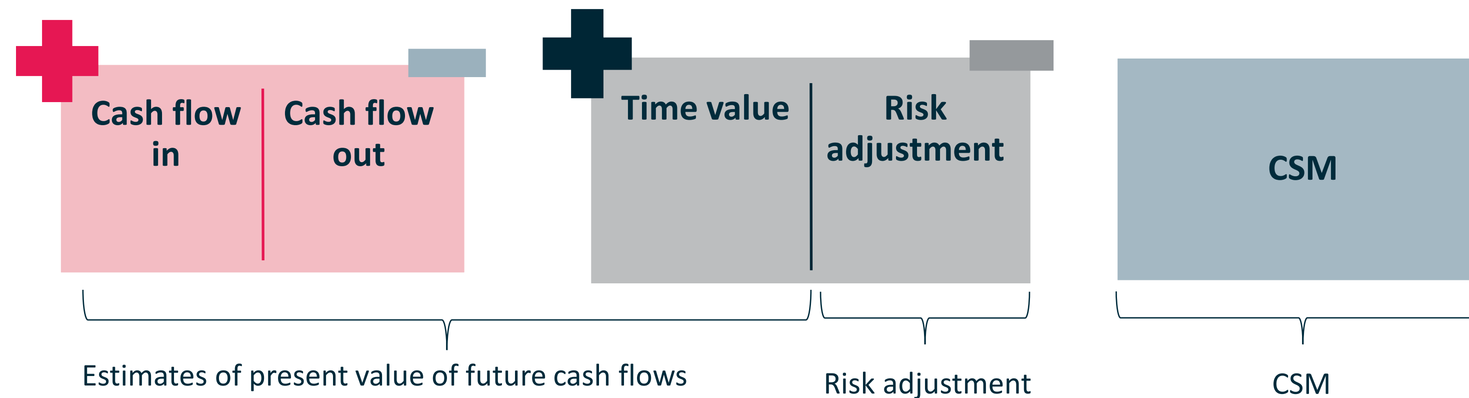
Carrying amount of insurance contracts - GMM



Insurance contract liability (or asset):

- Liability for remaining coverage:
  - Fulfillment cash flows:
    - Present value of future cash flows (cash flows; discount rate);
    - Risk adjustment.
  - CSM (profit from coverage to be provided in the future)
- Liability for incurred claims
  - Fulfillment cash flows:
    - Present value of future cash flows (cash flows; discount rate);
    - Risk adjustment.

Carrying amount of insurance contracts - PAA

Insurance contract liability (or asset):

- Liability for remaining coverage:
  - Simplified measurement based on unearned premiums.
- Liability for incurred claims
  - Fulfillment cash flows:
    - Cash flows (no discounting since claims are generally due within one year);
    - Risk adjustment.

Carrying amount of insurance contracts - VFA

Insurance contract liability (or asset):

1) Liability for remaining coverage:
    a) Fulfillment cash flows:
        - Present value of future cash flows (cash flows; discount rate);
        - Risk adjustment.
    b) CSM (profit from coverage to be provided in the future; including changes in the variable fee)
2) Liability for incurred claims
    a) Fulfillment cash flows:
        - Present value of future cash flows (cash flows; discount rate);
        - Risk adjustment.

Comparison taxation principles and accounting principles for insurance contracts

IFRS 17 vs taxation principles (1)

IFRS 17 vs principles of sound business practice	
IFRS 17	**Principles of sound business practice**
Comparative opening balance sheet per January 1, 2023, where the impact arising from IFRS 17 is recognized directly through the equity for statutory purposes.	Not in accordance with the principle of balance sheet continuity and the error theory.
PAA concerns no requirement for measurement of the CSM or for updating the obligations of insurance contracts for changes in discount rates or other financial variables.	In accordance with the principles of sound business practice, therefore no requirement for deviation from the calculated figures.
Insurance contracts are **grouped** if they concern the same risks and are issued within the same year.	The realization principle generally requires that profit be recognized on a portion of the agreement. This becomes impossible when insurance contracts are valued in a group.
Profitable insurance contracts are recognized on the balance sheet on the date as of the insurer has the contractual obligation to assume risks.	In accordance with the consistent practice (*bestendige gedragslijn*), an item should be entered on balance sheet for taxation purposes if it is known at the time of preparing the balance sheet. Furthermore, for taxation purposes insurers are only allowed to recognize a **premium reserve** (*provision unearned premiums*) and a **provision for claims** (*provision insurance contract liabilities*).

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IFRS 17 vs taxation principles (2)

IFRS 17 vs principles of sound business practice	
IFRS 17	**Principles of sound business practice**
Unprofitable (loss-incurring) insurance contracts are entered into the balance sheet at the earliest when there is an indication that the contract would be incurring losses, or the contract issue date.	An item should be entered on balance sheet for taxation purposes if it is **known** at the time of preparing the balance sheet. The principles of sound business practice allow the insurer to enter a **premium reserve** and a **provision for claims**. The unrealized loss on the insurance contract could, under specific circumstances, be recognized in the calculation of the taxable profit (in accordance with the realization principle and the principle of prudence). However, the cash inflow and cash outflow analysis is not particularly relevant for the calculation of the taxable profit.
Loss offsetting within the contract group is allowed.	Loss offsetting within a contract group can result in profit shifting, which is inconsistent with the realization principle.

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IFRS 17 vs taxation principles (3)

IFRS 17 vs principles of sound business practice	
IFRS 17	**Principles of sound business practice**
Expected cash flows are updated per balance sheet date, through discounted current estimates of future cash flows as well as profit and directly attributable costs of the contracts, up to the end of the contract.	For taxation purposes insurers are allowed to consider a (premium reserve/provision unearned premiums and a) provision for claims. This provision is determined based on the calculation of the present value of the future claims payouts at market interest rates.
Discounting at **current market-consistent discount rates**, based on the interest rate characteristics of the portfolios.	Discounting is considered at **market interest rates**.
Risk adjustment for timing and compensation for bearing insurance risk.	Not in accordance with the principle of prudence, since the risk adjustment requires more prudence than what is necessary based on the principle of prudence. Furthermore, the present value of future cash (in and out) flow is not a basis for determining the book value for taxation purposes of insurance liabilities. For taxation purposes only the expected future claims settlement/payouts are considered.

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IFRS 17 vs taxation principles (4)

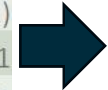
IFRS 17 vs principles of sound business practice	
IFRS 17	**Principles of sound business practice**
Acquisition costs are considered as part of the fulfillment cash flows and therefore considered in determining the book value for statutory purposes of the insurance liability (or asset).	Acquisition costs are charged directly in the calculation of the taxable profit. In case of life insurance are acquisition costs capitalized and depreciated as the insurance services are provided.
Unrealized profit from coverage to be provided in the *future* is reserved through the **CSM**.	Not in accordance with realization principle whereas profits are considered in the period in which they have actually arisen and have been realized. For taxation purposes profit are only considered when they are **reasonably certain**. Therefore, unrealized profits can not be considered as a basis for determining the book value for taxation purposes of a liability.
Recognizes changes in estimates of future cash flows from one reporting date to another, as an amount through profit or loss, or as an adjustment of the CSM (adjustment expected future profit).	Future cash (in and out) flow are not considered in the basis for determining the insurance liabilities. The CSM is not considered since profits are only considered when they are reasonably certain. Only the **expected insurance claims settlement/payouts** are considered for determining the insurance liabilities. This adjustment is not in accordance with realization principle and since future price adjustments are neglected.

New concept for insurance revenue

New revenue concept under IFRS 17

IFRS 4

P&L	20X1	20X0
Gross premiums	16,321	13,567
Premiums ceded to reinsurers	(816)	(678)
Investment income	9,902	9,030
Total income	**25,407**	**21,919**
Gross claims, benefits and expenses	(13,827)	(12,012)
Claims and expenses ceded to reinsurers	368	351
Acquisition costs amortisation	(1,259)	(1,150)
Change in insurance contract liabilities	(9,308)	(8,377)
Total expenses	**(24,026)**	**(21,188)**
Profit before tax	**1,381**	**731**



IFRS 17

P&L	20X1	20X0
Insurance revenue	9,856	8,567
Insurance service expenses	(9,069)	(8,489)
Incurred claims and insurance contract expenses	*(7,362)*	*(7,012)*
Insurance contract acquisition costs	*(1,259)*	*(1,150)*
Insurance service result before reinsurance^	**1,235**	**405**
Gain or (loss) from reinsurance	*(448)*	*(327)*
Insurance service result	**787**	**78**
Investment income	9,902	9,030
Insurance finance expenses	(9,308)	(8,377)
Net financial result	**594**	**653**
Profit before tax	**1,381**	**731**

New revenue concept under IFRS 17

- Gross premiums shall not be disclosed in the P&L for statutory purposes: calculation of the taxable profit based on the premium revenue method (*premieomzetmethode*) and the premium fraction method (*premiebreukmethode*) remains based on gross premiums (in notes to the financial statements).

- For taxation purposes:
  1) Derecognition of the fulfillment cash flow and the CSM on the balance sheet for taxation purposes;
  2) Derecognition of the liability for incurred claims;
  3) Recognition of the premium reserve and the provision for claims (insurance liabilities);
  4) Reversal of movement CSM;
  5) Reversal movement liability for remaining coverage;
  6) Reversal movement liability for incurred claims;
  7) Reversal adjustments through CSM (derecognition CSM);
  8) Recognition movement premium reserve (unearned premiums) and movement provision for claims.

VII. Implications of IFRS for the tax reporting

Analysis of the implications of IFRS 17 for the tax reporting

Tax reporting – IAS 12

Tax base is determined based on the principles of sound business practice:

- Purpose and scope of the principles of sound business practice
  - Deviations in the principles for determining the book value and the profit;
  - difference in the tax base and the carrying amount (deferred tax positions);
  - difference in the profit for statutory purposes and the taxable profit (current tax).

IAS 12:

- Deferred tax asset: deductible temporary differences
  - DTA recognized for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilized, unless they arise from the initial recognition of an asset or liability in a transaction that is **not** a business combination.
- Deferred tax liability: taxable temporary differences
  - DTL recognized for all taxable temporary differences , **except** to the extent that they arise from the initial recognition of an asset or liability in a transaction that is **not** a business combination.

No recommendation for recognition of a DTA or DTL based on initial recognition exception.

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VIII. Further remarks

Additional remarks concerning the implementation of IFRS 17

Additional considerations

- No further guidance of the local supervisory institution:
  - No amended reporting forms for insurers, insurance brokers etc.
  - DNB (the Netherlands): transition period of two years (2023 and 2024):
    - Supervision remains based on Solvency II: Risk quantification, risk management and risk transparency;
    - Additional reporting forms in accordance new financial statements (based on IFRS 17);
    - Provision for insurance claims/Technical provision: remains based on Solvency II;
    - Initial identified differences by DNB during consultations with insurers:
      - Specified cash flows (estimated future cash flows adjusted to reflect time value vs. best estimate of all cash in- and outflows required to settle obligations);
      - No deferral of acquisition costs under Solvency II;
      - Discount rate (risk free interest vs rates that reflect characteristics of the cash flows).
    - Solvency II: No focus on profit recognition.
    - Solvency II: There are no different measurement models for different types of insurance contracts (IFRS focuses on insurance groups determined at inception).

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Additional considerations

- Dutch tax authorities:
  - *Besluit winstbepaling en reserves verzekeraars 2001* remains applicable for determining the book value of insurance liabilities as well as the taxable (annual) profit.

- Importance of policy administration:
  - The measurement of the CSM, the identification of the loss component of the liability for remaining coverage, and the cumulative unrealized results on the transition date depend on events in the past.
  - These aspects of measurement and the subsequent presentation: require historical information.

Questions?

Thank you!

Contact us for further questions or consultations.

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