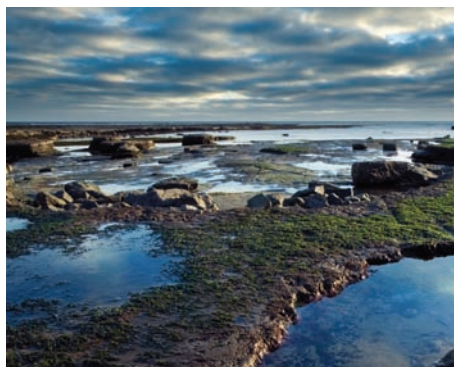


## General insurance reserves: new UK tax rules



**“Captives with UK parents are likely to be affected”**

Ian Morris



As a result of a concern that the tax relief received might be excessive, the UK has, for some time, imposed restrictions on the provisions established by general insurance companies for tax purposes.

The Finance Act 2000 attempted to do this by addressing any differences between the technical provisions set by general insurers in their accounts and the eventual claims amount. The legislation required extensive calculations and imposed an administration burden which was arguably disproportionate to any tax benefit.

### Captive impact

As well as UK companies, the requirements also affect “controlled foreign companies” which includes most captive insurance companies with UK parents.

### New regulations

The Finance Act 2007 repealed the previous legislation and introduced the concept of an “appropriate amount” as a limit on the reserves that would be allowable for tax. It also enabled regulations to be made which would set out how an “appropriate amount” should be calculated. These regulations became effective from 1 September 2009 and apply to accounting dates on or after 31 December 2009. As previously, captives with UK parents are likely to be affected.

The “appropriate amount” has three parts; unearned premiums, unexpired risks and outstanding claims. The first two are determined in accordance with accounting regulations. The value of outstanding claims is subject to three conditions shown in the table below.

### Consequence of not meeting requirements

If any of these conditions is not satisfied then the amount of the liabilities is deemed to be the undiscounted best estimate of the future cash flows relating to outstanding claims. This best estimate is defined as the mean of the distribution of potential outcomes.

### Additional HMRC power

Under the new regulations HMRC may request the general insurer (at the insurer’s expense) to provide a report as to whether (and, if so, the extent to which) the amount of any technical provisions stated in the accounts exceeds the appropriate amount.

We would not expect this power to be exercised often; however the cost involved in producing such a report could be high.

### Captives with UK parents

If a captive is a “controlled foreign company” and has routinely obtained actuarial reports to support the provisions held within the accounts, it should be possible to comply with the new regulations. Indeed there may well be some savings through the repeal of the old requirements. However, it is advisable to ensure that any report commissioned includes the specific written advice to meet the tax requirement and is available to fit in with the accounting timetable.

If a captive has not obtained actuarial reports previously, then the position is more challenging. The captive will have to consider whether the advice used to establish reserves comes from a “suitably skilled person” and is compliant with the actuarial standards. If so then the current approach may be able to be retained.

### Conclusions

If there is any doubt over the compliance of the advice with the new regulations on reserving, the captive should seek tax advice or consider commissioning an actuarial report. The cost of an actuarial report may well be less than the consequences of not meeting the regulations and is likely to be less than a report commissioned at the request of HMRC.

For smaller companies the cost of an actuarial report may be considered disproportionate. In such cases it may be possible to set reserves, for tax purposes, which are clearly not excessive. However, we recommend that tax advice be sought, in order that the risks are understood.

The new regulations may lead to some captives reconsidering their future. If it has been worth complying with the old rules then the new regulations should be manageable. However, they may make it more difficult for smaller captives to remain viable.

## Conditions for valuing outstanding claims

- A. Written confirmation that the estimated liabilities are not excessive. This confirmation must be based on a written opinion from an actuary or other suitably skilled person.
- B. The opinion must reflect the circumstances at the time the provisions are adopted by the general insurer.
- C. The amount of the provision must be in accordance with the generic and relevant specific standards set by the Board for Actuarial Standards.



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