

CEA position on the EC working document on the review of the operation of the Council Directive 2003/48/EC on taxation of income from savings

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The Comité Européen des Assurances ("CEA") is very interested in the European Commission's review of Council Directive 2003/48/EC on taxation of income from savings ("Savings Directive"), especially as regards the inclusion or not of insurance in the scope of the directive. CEA welcomes the opportunity to take an active part in the discussions with the European Commission's DG TAXUD ("EC") on this subject.

The ultimate aim of the Savings Directive is to enable savings income in the form of interest payments made in one Member State to beneficial owners who are individuals resident in another Member State to be subject to effective taxation.

Preamble 13 to the Savings Directive restricts its scope to savings income in the form of interest payments on debt claims. It specifically excludes issues relating to the taxation of pension and insurance benefits. In its working document the EC explains that the referred Preamble 13 clarifies that the current exclusion from the scope of the issues related to the taxation of pension and insurance benefits is a deliberate choice of the Council. Nevertheless, the EC understands that it would be worth considering if the current situation leads to distortions and if so, to what extent it could be solved without creating a disproportionate administrative burden on the ordinary activity of insurance companies and pension funds.

Question 17

Does the current exclusion from the scope of the Savings Directive of all benefits from pensions and insurance contracts lead to distortions in financial markets? To what extent is the competition between UCITS and life-insurance driven by the Savings Directive and not by other economic, commercial, legal, tax, etc. factors? How many individuals with an account in another Member State do put their savings in life insurance contracts rather than in UCITS just to avoid the Savings Directive obligations? Which amount of assets under management does this represent in the EU?

As a preliminary note, it is the CEA's opinion that the reply to the first question above must be supported by objective quantitative data indispensable to its accuracy. In this context, before developing any possible comments on a possible distortion in financial markets led by the current exclusion of all benefits from pensions and insurance contracts from the scope of the Savings Directive, a reply to the third question above must be taken into account.

This question refers to individuals who choose not to have a savings account or to close an existing account in another Member State in favour of buying life insurance in that other Member State and closing their savings account because of the reporting obligations foreseen in the Savings Directive.

In the CEA's view, the current exclusion from the scope of the Savings Directive of all benefits from pensions and insurance contracts does not lead to distortions in financial markets for the **three** reasons below stated.

1. Figures on cross-border life insurance activity

In its Expert Group on Taxation of Savings Questionnaire on Quantitative Elements (Quantitative Questionnaire), the EC has asked for *"as far as possible, the breakdown (amount of assets by type of investment / products and by country where such assets are held), for each of the years between 2002 and 2006, of the portfolio held by EU-resident individuals in other EU Member States but the one of residence:*

(...)

9.9 Revocable life-insurance contracts and annuity products where more than 40% of the underlying investment is made in debt claims, or in shares or units of UCITS or other undertakings for collective investment where the percentage of assets in debt claims is more than 40%

9.10 Occupational pension schemes (second pillar) and individual pension schemes (third pillar) where more than 40% of the underlying investment is made in debt claims, or in shares or units of UCITS or other undertakings for collective investment where the percentage of assets in debt claims is more than 40%."

As already informally transmitted to the EC, given the short notice available and despite the CEA efforts in obtaining the data in the exact terms as requested, this type of figures was not available from our Member Associations. Nevertheless, CEA was able to collect information on the premiums paid by EU-resident individuals of other EU Member States but the one of residence for 2005, on a cross border basis under Freedom of Services, for the life insurance activity, here included the activity related to products such as Unit Linked Life Insurance.

Indeed, the CEA was able to bring together 90% of the European Insurance Single Market and presented it together with the CEA position paper dated 29 June 2006, under reference MU 7126. For further information, the CEA invited the EC to address its request directly to the National Supervisory Authorities in each Member State which are in a better position to collect detailed information especially on the underlying investment of insurance, annuity and pension products than the National Insurance Associations members of the CEA.

At the last EC Expert Group on Taxation of Savings meeting, the CEA was requested to additionally present the quantitative data on cross-border life insurance activity for the years previous and subsequent to 2005 (year of the entry into force of the Savings Directive), in order to allow the analysis of the influence played by the Savings Directive in the cross-border behavior of the European Insurance Single Market.

The CEA was also requested to present and include the Luxembourg market figures on cross-border life insurance activities in the global aforementioned quantitative data.

In view of the EC request, the CEA has additionally included quantitative data on cross-border life insurance activity for 2003 and 2004 in its reply to the Quantitative Questionnaire. The CEA was not able to include the figures for 2006 since they will not be ready until April 2008. On the other hand, the available figures for 2002 did not include a significant part of the countries comprised in the analysis of the subsequent years presented and were therefore left outside this exercise.

Finally, the CEA has included the Luxembourg quantitative data on cross-border life insurance activities for the above mentioned years (please see the CEA reply to the Quantitative Questionnaire).

From previously described data, it is possible to come to the following conclusions:

- 1- The average ratio of cross-border life insurance activity is 6.3% in 2005;
- 2- The average ratio of cross-border life insurance activity has marginally increased from 5.27% in 2003 to 6.39% in 2004, before the entry into force of the Savings Directive;
- 3- The average ratio of cross-border life insurance activity was stable in 2004 (6.39%) and 2005 (6.30%), year of the entry into force of the Savings Directive;
- 4- The ratio of cross-border life insurance activity in two of the larger insurance markets – Germany and France – is of 0.3% and 0.8% respectively in 2005.

In addition, it should be noted that this data is affected by EU based migration. In fact, this type of life insurance activity is normally due to policyholders formerly resident in one Member State where they subscribed a life insurance policy with an insurance company operating at national level. Should these policyholders eventually move to a different Member State they would normally keep the life insurance policy as subscribed, since this type of insurance product involves, as a rule, a long term contract period and it would not in principle be affected by a short / medium term residency in a different Member State.

It is worth noting that the insurance related European Single Market is not built up at the policyholder level, but rather at corporate level, through well defined merger based affiliates structures which provide a workable business organization namely for national regulatory purposes. As a result, CEA concludes that the European Insurance Single Market is driven by strict regulatory conditions rather than by tax scenario avoidance.

Moreover, this particular reality of the life insurance business is already familiar to the EC. In fact, the Green Paper on Retail Financial Services (Green Paper) ¹ states on page 5 that *“with exception of UCITS, cross-border trade is limited and activity through cross-border establishment or mergers is lower than in most sectors (...)”*. It also recognises in particular the modest insurance cross-border activity stating that *“in insurance, consolidation of the industry has taken place through mergers and establishment rather than by opening branches and providing cross-border services. The volume of cross-border business is extremely small, with domestic insurance companies accounting for more than 90% of total premium income in most markets.”* This reality is further developed by a special reference to *“problems with tax deductibility (...)”* which *“(...) have proved an obstacle to the cross-border sale of some life insurance and pension products”* also on page 5.

Considering the above and in line with the Green Paper, the CEA concludes that although there is life insurance activity on a cross-border level, its amount is negligible in the whole European Single Market. This reality would imply that the subset of this amount, which might have been representing life insurance bought in lieu of savings accounts is immaterial.

As a consequence, we cannot conclude that the competition is distorted because of the Savings Directive rather than other factors which are more important levers.

¹ COM(2007) 226 final .

Finally, it would be worth questioning the terms of an eventual distortion of competition related to current exclusion of insurance, annuities and pension products of the scope of the Savings Directive such as referred to by the EC. Taking the cross-border life insurance figures into account, CEA concludes that competition between life insurance products and other financial products arises at national level. Therefore, CEA confirms that the competition between these products would not be driven by the Savings Directive, rather than by other economic, social and legal factors in the European Single Market.

2. Similar obligations to life insurance contracts and formal differences with other savings products

In most Member States, obligations at a national level to declare a life-insurance subscription made abroad to tax authorities already exist. Please find below the following national examples:

Germany

The payment of life insurance contracts is subject to German capital yield tax at the end of the contract, being this procedure also applicable to foreign insurance clients. In order to obtain tax relief or a complete refund because of double taxation agreements the taxpayer would have to make a request to the federal central tax office. Considering the international exchange of information the foreign tax authorities are informed about every payment made arising from an insurance contract.

Additionally, every annuity payment made by an insurer to his clients has to be reported to a central German authority. Should it be necessary to inform the foreign tax authorities about these payments, this central authority should be able to select the payments made to foreign insurance clients and send this information to the former.

France

According to French tax rules, when a policyholder subscribes a life insurance contract with an insurer located abroad, he has to declare any modification and refunding carried out during the year with his annual declaration of income. He has to provide the following information:

- name, surname, address, date and place of birth of the policyholder;
- address of the insurer;
- name of the contract, its number and type of guaranteed risks;
- moment from which the risk is guaranteed and the length of this guarantee;
- dates of entry into force of modifications and of total or partial refunding carried out during the year.

United Kingdom

United Kingdom insurers are required, on an annual basis, or less frequently if requested by the British tax authorities, to provide information about:

- policyholders of Overseas Life Insurance Policies who have taken up residence in the United Kingdom;
 - the amount of any policy gains made by such policyholders; and
- will need to keep records to enabling them to supply the information.

Companies will not be required to provide details of policy benefits where they have supplied a chargeable event certificate in respect of the same event.

Italy

In Italy, a number of rules are in force with the aim of monitoring the amount of financial activities abroad giving rise to investment income and the transfer of money (from) abroad relating to resident taxpayers.

In particular, where a life policy is taken out with a non resident insurer, the contract takes into account the following elements:

- the tax return of the policyholder, who is obliged to communicate separately the global financial assets held abroad and the transfers of money relating to those assets, provided that each of the amounts exceeds € 12,500 per year and the contract has not been taken out via a resident financial intermediary in charge of the transfer of the sums;
- otherwise, the resident financial intermediary (bank, asset manager etc.) is subject to a general obligation to transmit to the tax authorities the transfer of sums abroad or from abroad on behalf of resident taxpayers exceeding € 12,500 per year;
- when a benefit arising from a life policy is paid by the non resident insurer, the resident taxpayer must declare the investment income in the tax return as foreign income subject to the same tax (12.5%) as if it were paid by a resident insurer. However, since 2003 the non resident insurance companies have been entitled to apply - directly or through a tax representative – the 12.5% withholding tax: in this case, there is no need to inform the tax authorities tax authorities;
- where individual pension plans taken out with a non resident insurer are concerned, Italian legislation requires the appointment of a tax representative in order to provide the tax authorities with all the information concerning the contract (policyholder's data, number, inception date, premium paid and, eventually, payouts).

The Netherlands

Regardless of the policyholder residency, Life insurers have to inform the Dutch tax authorities of:

- Yearly:
 - i. name, address and other personal data of the policy holder;
 - ii. type of contract;
 - iii. the actual value of the policy or, when premiums are tax deductible, the amount of premium paid during the year;
- In case of pay out of the contract or certain well described events, that are not allowed by tax regulations:
 - iv. The above mentioned data and the amount that is paid out or the event that has occurred.

The value of a life insurance contract is taxed yearly at a 1.2% income tax rate, except for those contracts with tax deductible premiums. For these contracts, the yearly payments during the payout period are taxed with the usual income tax of 33% up to 52 % (for age 65+: 15% till 52%)

At this stage, it is possible to conclude that a possible inclusion of income of life insurance, annuity and pension contracts within the scope of the Savings Directive would not answer to a possible additional need of information on the insurance policy terms and payment of benefits to the foreign tax authorities.

Against this background, as clarified above, the inclusion of life insurance contract within the scope of the Savings Directive would result on the doubling of the insurance companies reporting obligations, placing an extraordinary administrative burden on the operators of this activity sector, especially when the reporting requirements do not exactly match.

Considering the above, CEA concludes that the competition between UCITS and life-insurance is driven by real economic, commercial, legal and tax factors and not by the absence of reporting obligations to the tax authorities under the Savings Directive.

3. Material differences between life insurance and other savings products

Nature of life insurance products

CEA underlines that the key element of an insurance contract is risk coverage. In this view, the payout of the contract happens upon the occurrence of a risk, which may result in the provider incurring a loss under an individual contract.

The technical distinction between insurance and savings products must involve a conceptual exercise based on the above mentioned element. In the presence of products which provide the customer both with risk coverage and a savings vehicle, the single exercise to determine their insurance character should rely on the objective presence of the risk coverage element previously referred to.

In providing insurance products, insurance companies accumulate funds to ensure that they are able to fulfil their obligation with respect to policyholders. Therefore it is necessary to invest the insurance premiums to provide risk coverage indispensable to characterize any insurance contract.

Considering the above, CEA is strongly opposed to any approach which takes into direct consideration the assets underlying an insurance contract, disregarding tout court their rationale / contractual framework always based on the risk coverage which typifies an insurance contract.

Finally, it is worth noting that the revocability of an insurance contract such as suggested by the EC is irrelevant in its survey on potential distortion of the internal market. As previously referred, risk coverage is the key element to qualify a contract as insurance.

CEA concludes that any approach of the investment pursuant to an insurance contract for taxation of income from savings purposes should be based on the rationale of the same investment, i.e. the risk coverage, which typifies any insurance contract and that its revocability, contrary to what has been suggested by the EC, is not a decisive criterion for its qualification as a savings product.

Regulatory environment of life insurance contracts

The insurance business is a highly regulated sector, whether at the European or at the National level. The restrictions in the insurance business regulatory environment concern directly not only, at a first stage, the persons that are legally authorised to carry out the insurance activities, but also, at a second stage, the activities that can be provided by the legally authorised insurance undertakings. According to European Parliament and Council Directive 2002/83/EC, concerning life assurance ("Life Assurance Directive"), insurance companies qualifying as such under their rules are absolutely conditioned to selling insurance products.

Considering the above, the activity scope of an insurance undertaking qualifying as such is pre-determined and mandatory under the applicable insurance regulatory environment. As the licence pursuant to which an insurance company carries out its activity could not include activities other than insurance, the insurance undertakings are legally bound to pursue them exclusively.

Insurers fulfil the role of guarantor for the investment pursuant to the insurance contract. The applicable prudential regimes bind insurance companies to present a minimum solvency capital to maintain a minimum profitability of survival over a determined timeframe. As a result, a significant level of capital must be held in addition to the assets backing the underlying investment.

CEA concludes that any approach consisting of taking into consideration directly the underlying assets of a life-insurance contract acting as if the latter would not exist will not only lead to legal uncertainty about the definition of life insurance provided by the Life Assurance Directive but also lead to confusion on the interpretation of the solvency capital prudential regimes that currently bind insurance companies.

| Conclusion

Question 18

Depending on your reply to the different elements of question 17, would it be desirable to amend the Savings Directive in order to include in its scope part or all of the benefits from revocable life-insurance, pension or annuity products when the underlying prevailing investment is directly or indirectly made of interest generating financial products?

It is the CEA's conviction that the competition in financial markets is not distorted by the current exclusion of life-insurance as well as annuities and pensions from the scope of the Savings Directive given that:

1. Contrary to UCITS, the cross-border life insurance activity is extremely small, such as recognised by the EC in the Green Paper;
2. In most Member States, namely the ones representative of the largest share of the European Single Market, there already exist obligations at a national level to declare a life-insurance subscription made abroad to tax authorities;
- 3.1 The approach of the investment pursuant to an insurance contract for taxation of income from savings purposes should be based on risk coverage, which is the rationale of the same investment, and not on its revocability, as suggested by the EC;
- 3.2 Taking into consideration directly the underlying assets of a life-insurance contract acting as if the latter would not exist would lead to legal uncertainty about the definition of life insurance provided by the Life Assurance Directive and to confusion on the interpretation of the solvency capital prudential regimes that currently bind insurance companies, whereas the asset managers are left out of their scope.

As the current exclusion of insurance, annuities and pensions income from the scope of the Savings Directive does not lead to distortions in financial markets for the above stated reasons, CEA concludes that life-insurance as well as annuities and pensions must be maintained outside the scope of the Savings Directive.

Should an extension of Savings Directive to benefits from life insurance, pension and annuity products be envisaged, such a change would lead to a weakening of the protection given by life insurance and pension products which assumes a particular importance taking into account the ageing of the population and the increased role pension and insurance products will play in the near future.

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