

## CEA additional comments on the discussion arising at the Fourth Expert Group on Taxation of Savings meeting

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<b>Related CEA documents:</b>	CEA position paper on the EC working document on the questions arising from a first analysis of the comments received on the Working Document prepared by the EC services on 14 March 2007 for the Expert Group on Taxation of Savings, dated 23 April 2008, Annex 1 to MU 8102		
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Further to the discussion held at the fourth European Commission (EC) meeting of the Expert Group on Taxation of Savings that took place on Monday, 19<sup>th</sup> of May 2008, the CEA is pleased to provide you with an additional note on the insurance related outcome of the same discussion.

### I. Background

After the insurance sector presentation provided on the basis of the CEA position paper on the EC working document on the questions arising from a first analysis of the comments received on the Working Document prepared by the EC services on 14 March 2007 for the Expert Group on Taxation of Savings, dated 23 April 2008, Annex 1 to MU 8102 (CEA Position Paper), the EC questioned whether it would be effective to adopt one of the two following alternatives as possible amendment recommendations:

1. To globally include the income of life insurance contracts in the scope of the Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation and taxation of insurance premiums (Mutual Assistance Directive);
2. To globally include the income of all types of insurance contracts in the scope of the Mutual Assistance Directive and simultaneously include in the scope of the Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments (Savings Directive) the income of life insurance contracts that would fulfill a double criterion:
  - They would provide an ancillary risk coverage;
  - They would be based on underlying investment products that are already covered by the Savings Directive.

Additionally, the CEA understands that the EC questioned on the existence of anti-avoidance rules in the United Kingdom (UK), according to which the life insurance policies that provide minimal risk coverage and entail an individual asset management are subject to taxation as soon as income accrues.

## | Executive Summary

1. It is not possible to measure and report the annual gain with insurance products, as they do not pay out income on an annual basis. In general income and gains accrued within the life insurance policy are not allocated to any particular individual, until surrender.
  
2. Requiring all life insurance companies to operate a system where the Savings Directive would apply to life insurance products, when in almost all EU countries there are already effective rules to require domestic and foreign insurers to report surrender values at a national level, will have severe impacts on the relative competitiveness of EU based life companies.
  
3. The real problem the EC proposes to solve by means of the second alternative is negligible in the whole European Single Market since the subset of this amount, which might have been representing life insurance bought in lieu of savings accounts, is even more insignificant and immaterial compared to the amplitude of a measure entailing the creation of new severe and unnecessary regime for life companies and tax authorities in Member States.
  
4. The UK tax regime is deliberately penal to discourage policies that link to investments outside the permitted asset categories and therefore would not be suitable to tackle the problems the EC wishes to cover on a pan-European level with the Savings Directive review.
  - 4.1 The UK regime does not
    - Impose any special reporting arrangements on insurers to separately identify income or interest paid.
    - Involve cross-border reporting ie it is a national measure to ensure that the UK government is able to tax income of UK residents in the way they choose to.
    - Interact with the Savings Directive arrangements as it does not cover products that are currently subject to that directive.
  
  - 4.2 Compare this to the Savings Directive, which
    - is not intended to discourage saving or use of any one product structure eg UCITS or bank account, merely to ensure that interest paid to the individual is subject to tax.
    - Is only aimed at identifying "interest paid" only, not other forms or income or gains
    - Is applied to savings and investment products that already report that interest separately and annually to the investor, as that is how those products are set up.
  
  - 4.3 For these reasons the CEA is not sure why this particular anti-avoidance measure has been highlighted as part of this debate.

## II. CEA's comments

### A) On the alternatives suggested by the EC

On the first alternative suggested by the EC, it is still uncertain how the EC proposes to include the income of life insurance contracts in the scope of the Mutual Assistance Directive. Indeed, it is not clear how this alternative would meet the concerns of the EC since the exchange of information as it is currently outlined would only occur upon the taxable event of a life insurance policy and, as above described, this is not the case of accrued income generated by an insurance policy. The CEA remains at your disposal and looking forward to be fully engaged in the discussion and research phase that might follow the current stage.

On the other hand, it is the CEA's conviction that the second alternative is not appropriate and is in full opposition with the CEA Position Paper, not only for the reasons there stated, but also for the arguments identified below.

When deciding upon the scope of the Savings Directive, the Member States deliberately limited its scope to the taxation of savings income in the form of interest payments **on debt claims**. Payments by means of pension and insurance benefits were excluded due to the particularities of those products (para 13 of the preamble of the Savings directive).

The reasons for this decision are still valid today since insurance is not a saving product in the terms of the Savings Directive given the following set of features:

- issue of ownership of the underlying assets;
- different prudential rules applicable;
- due to those differences, technical impossibility to measure and report the annual gain with an insurance product.

Indeed, the CEA understands that it is not possible to measure and report the annual gain with insurance products, as they do not pay out income. In general income and gains accrued within the life policy are not allocated to any particular individual, until surrender. Furthermore, the tax point on an insurance policy, if there is one, is commonly either at the beginning of the contract, or when money is withdrawn/the policy is surrendered. Most Member States already effectively identify tax events through domestic disclosure regimes or, in the case of freedom of services business, through the appointment of a fiscal representative.

It is unclear how the Expert Group thinks the annual reporting of "interest payments" of the Savings Directive could apply to Unit-Linked policies. There is no annual "interest" paid, or deemed to be paid, from a life bond. So the EC would be artificially creating a completely new rule for life products that does not currently exist. This would reflect a misunderstanding of the life insurance concept and would impose huge additional and unnecessary burdens on life companies and tax authorities in Member States.

Whether this rule applied to "any interest" received in the life policy or, as with UCITS, only when the interest element formed the major income stream, all insurers would have to operate the system – as the inability to define product mix within a life policy fund and the ability for investors to change investments whilst holding on to a policy mean there is always a risk that a policy could move from being wholly equity based to cash based and back. Equally, despite the minimal cross-border activity (as shown by the CEA quantitative data) all companies would have to operate this on all products in case someone with a policy in one country moved to another jurisdiction.

Requiring all life insurance companies to operate such a system, when in almost all EU countries there are already effective rules to require internal and foreign insurers to report surrender values at a national level, will have severe impacts on the relative competitiveness of EU based life bonds. This surely runs counter to the EU stated aim to encourage cross-border activity.

The CEA also understands that the EC is under a political pressure to tackle effectively the taxation of income from savings and that alternative solutions have to be quickly outlined. However, it is also the CEA opinion that the solution presented under the second alternative would not be technically suitable for this purpose for all the reasons above identified and for the arguments stated in the CEA Position Paper.

## **B) On the concrete problem the EC proposes to tackle**

Furthermore, the CEA additionally brought together and presented the quantitative data on cross-border life insurance activity for the year 2006 the first full year of application 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.

As stated in the CEA Position Paper and evidenced in the quantitative data provided, it is possible to come to the following conclusions:

- 1- The average ratio of cross-border life insurance activity is 6.5% in 2006;
- 2- The average ratio of cross-border life insurance activity was stable in 2004 (6.67%), 2005 (6.53%), year of the entry into force of the Savings Directive and in 2006 (6.5%);
- 3- The ratio of cross-border life insurance activity in two of the larger insurance markets – Germany and France – is only of 0.3% and 0.8% respectively in 2006.

Although there is life insurance activity on a cross-border level, the real problem the EC proposes to solve by means of the second alternative is negligible in the whole European Single Market. Indeed, the above reality implies that the subset of this amount, which might have been representing life insurance bought in lieu of savings accounts, is even more insignificant and immaterial as compared to the amplitude of a measure entailing the creation of new severe and unnecessary regime for life insurance companies and tax authorities in Member States.

## **C) On the British anti-avoidance rules**

The EC questioned on the existence of anti-avoidance rules in the UK, according to which the life insurance policies that provide minimal risk coverage and entail an individual asset management are subject to taxation, as soon as income accrues. The CEA understands that this reference regards the specific UK anti-avoidance measure covering “personal portfolio bonds”. Nevertheless, it is not clear how this is seen as helping on the Savings Directive debate for the reasons below stated.

### **1. The legislation: Section 515 of the Income Tax (Trading and Other Income) Act 2005.**

The “personal portfolio bond regime” was introduced to impose a stricter tax regime on life policies in very specific cases where the policyholder (or someone acting on their behalf) or ultimate beneficiary has a special arrangement to control the selection of certain categories of asset held in a policy. This is anti-avoidance legislation designed to discourage individuals from holding portfolios of listed and private equities through the medium of an insurance policy.

However, a policy is not a personal portfolio bond merely because its terms permit the selection of assets.

The UK legislation lists certain categories of assets, which the UK Government treats as “acceptable” investment links within a policy that gives the policyholder the power of investment selection. In general the asset must be available for selection to all policyholders, and must be “pooled” in nature, or cash. The list of acceptable links is as follows:

- property chosen by the insurer to be held in an internal linked fund;
- units or shares in a collective investment scheme, whether a unit trust or open-ended investment company (the UK equivalent to SICAV);
- shares in an approved investment trust;
- cash;
- a life policy, unless it is excluded because it is a personal portfolio bond or the investor has control over the assets selection in that policy;
- general indices, provided these are recognised indices such as the retail price or share index or other government indices.

It also does not apply to any pension policy, presumably as once the assets is within a pension wrapper it must be used for pension purposes to provide a taxable income stream post retirement.

In cases where the individual has control over the asset selection to such a degree that the bond becomes a personal portfolio bond, the tax rules then impose a annual tax charge on the policyholder, based on notional deemed gains that bear no relationship to the performance or mix of the investment links. The charge occurs on the last day of each policy year, following the start of the policy, if those assets are still in the fund at that date.

## **2. Impact on the insurer**

The insurer is required to report the annual gain to a policyholder and, if the gain is large enough, to the UK Revenue in the same way as for gains from normal taxable events.

As the contractual terms set out what sort of assets the policyholder can select, it is clear to the insurer whether a life policy will be a “personal portfolio bond” or not.

Therefore the company will know whether a policy needs to be treated on this different tax basis. If they are offering such products they will already know they have to develop systems to annually calculate and report gains on that policy. As the charge is not linked to any economic value, there is no requirement for the insurer to separately identify the underlying investments, whether interest bearing or not.

The reporting requirements are no different to the normal reporting requirements on surrender of all other life policies. Overseas providers are also required to comply with these rules for policies held by UK resident investors.

## **3. What is reported**

As with the normal taxable events regime on the surrender of a life policy, the insurer has no requirement to separately identify underlying investment links or the income arising from them. It merely states the notional deemed gain made on the whole investment over that year.

#### 4. Level of risk attached to the policy

The types of asset that could make a policy into a personal portfolio bond are mostly likely to be direct equity investments or individual securities.

Whether there is any life risk/mortality risk attached to the policy is irrelevant, but we assume the levels of life and mortality risk will be low, as this is intended to be an investment arrangement.

#### 5. Comparison with the Savings Directive

The personal portfolio bond legislation is intended to catch a very narrow type of insurance policy. It is not intended to cover normal types of life policy or policies containing normal asset mixes, such as cash or collective investments.

The tax regime is deliberately penal to discourage policies that link to investments outside the permitted asset categories. It is however our conviction that it would not be suitable to tackle the problems the EC wishes to cover on a pan-European level with the Savings Directive review. In particular, this regime might not be appropriate to offer a solution to a wide range of different individual concerns expressed by different Member States on the Savings Directive review.

Furthermore, the UK regime does not

- Impose any special reporting arrangements on insurers to separately identify income or interest paid.
- Involve cross-border reporting ie it is a national measure to ensure that the UK government is able to tax income of UK residents in the way they choose to.
- Interact with the Savings Directive arrangements as it does not cover products that are currently subject to that directive.

Compare this to the Savings Directive, which

- is not intended to discourage saving or use of any one product structure eg UCITS or bank account, merely to ensure that interest paid to the individual is subject to tax.
- Is only aimed at identifying "interest paid" only, not other forms or income or gains.
- Is applied to savings and investment products that already report that interest separately and annually to the investor, as that is how those products are set up.

For these reasons the CEA is not sure why this particular anti-avoidance measure has been highlighted as part of this debate.

We would definitively not agree that this suggests that life insurance companies are able to report annual interest paid to policyholders from policies within any normal life insurance fund structure.

We would also argue against any implication that these measures indicate that normal insurance policies are not fully taxed, as these are clearly only aimed at policyholders using specific and unusual policy structures.

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CEA is always available and looking forward to assisting the EC and the Council in all questions mentioned above, as well as in any other questions that arise in the course of discussion.



## | About CEA

The CEA is the European insurance and reinsurance federation. Through its 33 member bodies, the national insurance associations, the CEA represents all types of insurance and reinsurance undertakings, e.g. pan-European companies, monoliners, mutuals and SMEs. The CEA represents undertakings that account for approximately 94% of total European premium income. Insurance makes a major contribution to Europe's economic growth and development. European insurers generate premium income of €1 065bn, employ over one million people and invest more than €6 900bn in the economy.

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