

General insurance reserves: the "appropriate amount" allowable for tax

Finance Act 2007 repealed legislation (section 107 of Finance Act 2000) which dealt with any differences between the technical provisions set by general insurers (including Lloyd's corporate names) in their accounts and the eventual outcome of those claims. The legislation was complex and gave rise to lengthy calculations.

The replacement legislation, introduced in Schedule 11 to the Finance Act 2007, is based on following the financial accounts, but allows an officer of HM Revenue & Customs to determine an amount called the 'appropriate amount'. If the provisions set at the end of the period of account exceed this amount, the excess is not allowed as a tax deduction for that period, but a compensating adjustment is made the following period. The rules apply to insurers regulated by the Financial Services Authority (FSA), UK branches of overseas insurers, captive insurance companies subject to controlled foreign company apportionments and Lloyd's members.

Schedule 11 provided a power to introduce regulations that would set out how the appropriate amount is to be determined. Following extensive consultations with the representatives of the industry, these regulations have now been laid and come into force on 1 September 2009. In relation to a general insurer (other than a Lloyd's member) they will have effect for periods of account ending on or after 31 December 2009. For a member of a Lloyd's syndicate, the rules will first apply to syndicate results declared in 2010 (ie the 2007 year of account and run-off from earlier years of account).

The appropriate amount for general insurers and Lloyd's syndicates carrying on a general insurance business is the aggregate of:

1. the provision for unearned premiums determined in accordance with the Large and Medium Sized Companies and Group (Accounts and Reports) Regulations 2008 (the 'Accounts and Reports Regulations')
2. the provision for unexpired risks determined under the Accounts and Reports Regulations, and
3. the estimated amount of outstanding claims from the general business.

For a general insurer that is not a member of a Lloyd's syndicate, there are a number of conditions which all need to be met in relation to the provision for outstanding claims for the appropriate amount to be the figure in the accounts:

- A. The general insurer must give confirmation in writing with the tax return that the provision is not excessive and that confirmation must be based on the written opinion of 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 (generally the time at which the directors approve the statutory accounts)
- C. The amount of the provision in the accounts must be in accordance with standards set by the Board for Actuarial Standards (or equivalent for non-UK resident insurers)

If any of the above conditions are not met, the amount of claims outstanding is the general insurer's undiscounted best estimate of the future cash flows in respect of claims outstanding. Therefore, if the provision in the accounts is outside of an actuarially recommended range or the conditions above are not met, a general insurer faces being denied a tax deduction for the excess of the accounts provision over the undiscounted best estimate, which could potentially be significantly different.

A further matter which general insurers need to be aware of is that, in addition to the normal information powers in relation to tax enquiries, HM Revenue & Customs will have the power to require a general insurer to obtain an independent report (at their own expense) on whether the provisions in the accounts exceed the appropriate amount and, if so, by what amount. HM Revenue & Customs has said that this power would not be routinely used in enquiries; however, the costs associated with producing such a report would be significant.

The rules represent a significant compliance challenge and general insurers will need to ensure that they have a robust filing position in relation to their technical provisions. General insurers will need to consider whether the current basis for calculating their technical provisions would meet the rules and, if not, the action required in order to comply.

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