TAX CONSIDERATION ARISING FROM IFRS 17

WHAT INSURANCE COMPANIES LOCATED IN CURAÇAO, ST. MAARTEN, ARUBA AND CARIBBEAN NETHERLANDS NEED TO KNOW!

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IFRS 17 is the newest accounting standard for insurance contracts and replaces IFRS 4. IFRS 17 becomes effective for annual periods beginning on or after January 1st, 2023. It can be considered as one of the most significant accounting changes for insurance companies of the past decade, with a broad impact on the operational, financial, tax and reporting functions of insurance companies.

IFRS 4 allowed entities to continue to use their accounting practices that existed prior to their first adoption of IFRS 4. This entails that insurance companies were using different accounting policies. IFRS 17 changes the accounting practices because it requires consistent accounting for all insurance contracts. Mainly to make the financial statements simpler to compare across insurance companies.

ACCOUNTING TREATMENT IFRS 17

IFRS 17 requires that profit is offset with a liability, the so-called Contractual Service Margin ("CSM"). Under IFRS 17, the insurance contracts are reviewed, and the CSM is calculated of all unearned profit from the insurance contracts. The CSM is gradually released over the term of the contract, so that the profit from the contract is realized by the insurer over multiple future accounting periods as it provides services under the contract.

The new requirements may significantly affect the amount of insurer's annual profit. Insurers will generally need to calculate the CSM at the transition date when they adopt the new standard, applying the new rules with adjustments in the retained earnings. Under this approach, an insurer restates its financial statements to recognize and measure insurance contracts as if IFRS 17 has always been applicable and recognize the net difference from the old rules in equity on the transition date. The portion of profit previously recognized in retained earnings for contracts issued prior to transition, that are still unearned at the time of transition, will be included in the CSM and realized over future accounting periods.

In effect, this framework pretends that IFRS 4 never existed. The effect of IFRS 4 is completely reversed under IFRS 17. This could entail that insurance companies have already paid profit tax under IFRS 4, so they may face double taxation. The same profit could be recognized twice, under IFRS 17 and under IFRS 4.

The challenge is that for each insurance contract it is necessary to consider how profit, liabilities and assets were calculated under IFRS 4. We cannot consider IFRS 4 a uniform accounting standard, since all insurance companies applied their "own" accounting practices that existed prior to their first adoption of the IFRS 4 standard.

LOCAL TAX LEGISLATION AND REGULATIONS FOR INSURANCE COMPANIES

Tax implications concerning the implementation of IFRS 17 depends on local tax legislation and regulations. In some countries, the taxation of income from premiums received or earned is based on specific rules. In other countries, the taxation could be aligned with the accounting standards.
The following tax legislation and regulations are applicable for Curaçao, St. Maarten, Aruba and Caribbean Netherlands.

Curaçao and St. Maarten

If a company conducting an insurance business is established in Curaçao or St. Maarten, the profit is determined on the basis of the regular profit calculation method for the profit tax. However, there is the possibility to opt for the premium turnover method for a period of five years. The premium turnover method means that a certain percentage of what is received in premiums and capital in any fiscal year is considered the profit of the insurance company. For life insurance, this percentage is set at 10 percent, while for other insurance this percentage is set at 20 percent.

For the profit of a foreign company conducting an insurance business through a permanent establishment in Curaçao or St. Maarten, it is in principle mandatory to use this premium turnover method for the profit calculation. It is also possible for a permanent establishment of a foreign company conducting an insurance business to use the premium fraction method. Under this premium fraction method, the premiums and capital received in Curaçao or St. Maarten are divided by the total amount of worldwide premium and capital turnover, and then multiplied with the worldwide taxable income.

Aruba

For Aruba, almost the same applies as for Curaçao and St. Maarten regarding the regular profit calculation and the premium turnover method for the profit tax.

The difference between Aruba on one hand, and Curaçao and St. Maarten on the other hand, is the fact that Aruba has abolished the premium fraction method for calculating the profit of insurance companies. The Tax Authorities of Aruba require the permanent establishments located in Aruba of foreign insurance companies to use the premium turnover method for profit calculation.

Caribbean Netherlands

If the insurance company is established in the Caribbean Netherlands (for tax purposes), IFRS 17 has in principle no tax consequences for the company. This is because no profit tax applies in the Caribbean Netherlands.

If insurance entities apply and continue to apply the premium turnover method, IFRS will have no impact on the calculation of the taxable income. However, for insurance companies that apply the normal profit calculation method and the premium fraction method, IFRS can have significant impact on the taxable income. Therefore, we will continue to focus on insurance companies that apply these methods.

The tax treatment of IFRS 17 depends on whether local tax laws and regulations could follow IFRS 17. This means whether the normal profit tax calculation method could follow IFRS 17 or not. This has not been announced by the local Tax Authorities yet.

If IFRS 17 is in line with the local tax legislation and regulation, the transition to this new accounting standard will be less complicated for the insurance companies established in Curaçao, St. Maarten or Aruba.

We will chart both cases, if Tax Authorities choose to follow IFRS 17 or not.

TAX TREATMENT FOLLOWS ACCOUNTING TREATMENT IFRS 17

In this case, insurance companies should have the current tax position assessed by an expert to determine the extent to which profit tax has already been charged based on IFRS 4. The latter is to avoid double recognition of profit under IFRS 17. Thus, to prevent double taxation.

TAX TREATMENT DOES NOT FOLLOW ACCOUNTING TREATMENT IFRS 17

If IFRS 17 is not followed for profit tax purposes, insurance companies face a change in their deferred tax positions. If IFRS 17 is not followed, no retroactive prior liability will be recognized on the insurance company's balance sheet for tax purposes. Consequently, there will be a temporary difference, changing the insurance companies' deferred tax position.

In both cases, whether IFRS 17 is followed for profit tax purposes or not, we recommend that you have the current, deferred and uncertain tax positions reviewed by experts in the field. You can certainly avoid paying profit tax on the same profit twice.

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