SOCIETY OF ACTUARIES

Article from:

International Section News

June 2001 – Issue No. 25

New Tax Regime Extends Attractions of Ireland Centre for Cross-Border European Life Business

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Editor's Note: This article is reprinted with permission. It last ran in The European Life Insurance Report, *Volume 1, Issue 1, in August, 2000.*

Introduction

Ireland's success as a favored home for cross-border life assurance companies has been an undeniable fact in the 1990s. The creation of Dublin's International Financial Services Centre (IFSC) by the Finance Act 1987 sowed the seeds of a new financial services industry, which has more than achieved its employment and commercial objectives through an influx of new international life offices. Many observers waited with trepidation to see what the future held after the effective closure of the IFSC to new entrants at the end of 1999. Any fears in this regard have been completely dispersed by the progressive decisions of the Irish authorities, now enacted in the Finance Act 2000, which mean that the attractions of Ireland as a domicile for cross-border life companies have actually improved notwithstanding the closure of the IFSC.

The Recent Past

The IFSC has succeeded as a life assurance centre, in part through the excellent marketing by the Industrial Development Agency (IDA Ireland) and in part through two significant taxation incentives. Of these, the incentive that always grabbed the press headlines was the special 10% corporation tax rate for IFSC companies. In reality however, far more important for life assurance companies that the 10% tax certificate went hand in hand with gross roll-up (GRU) on policyholder funds. In other words, the assets attributable to IFSC policyholders grow without direct taxation of the investment return.

This taxation result made the IFSC very appealing for investment assurance business. Importantly, it also places the IFSC on a competitive footing with its closest EU and non-EU competitors (Luxembourg and Isle of Man respectively). For this reason, increasingly more and more start-up EU life offices have chosen Dublin IFSC as their HQ.

Part of the attractions of Dublin's IFSC has been fiscal in nature, as described above. Equally important though, is the modern regulatory framework that exists in Ireland for life assurance business. (The insurance regulatory framework in this respect is the same for both domestic and IFSC companies).

Ireland, like the U.K. (and Canada, Australia, USA, etc.) relies upon the statutory appointed actuary within its regulatory framework. Its regulatory approach has for many years been "hands-off" with companies free to design and price products, calculate reserves, and manage their business with a framework underpinned by professional actuarial responsibility, guidance, and a healthy degree of discretion. Products, therefore, are innovative and modern (and do not require prior regulatory approval); unit linked products are long-established. The fact that Ireland has operated in this way for many years also means that it has a pool of expertise and available third-party providers.

For many readers already accustomed to such freedom, this will obviously be seen as normal; however, the past experience in many EU states — Germany, Italy, and Sweden, for example — has been completely the opposite and, regardless of EC directive, regulators have been slow to change. Furthermore, to most practitioners, the regulatory touch in Ireland, whilst being fully compliant with the Framework directives, is also lighter than in the U.K. and Luxembourg. Regulatory arbitrage is therefore both possible and real, supported by the right of establishment and the freedom to provide services under the three EC Life Directives.

For all of these reasons, Dublin IFSC has been attractive to companies of Scandinavian, Italian, North American, and British parentage, amongst others. Indeed, the growth and success of the IFSC sector is such that the larger IFSC companies are now writing more new business than the long-established, largest domestic Irish insurers.

The Present

Several aspects to the 10% IFSC tax / GRU position were problematic, however, and would lead to conflicts in the longer term.

For one thing, GRU was nothing new in a European context; indeed, it is the most prevalent treatment amongst other EU member states. However, it was new for Ireland because "domestic" life companies were taxed on a completely different basis: the so-called "I-E" basis, being the taxation of the excess of investment income gains over expenses. (Whereas GRU operates normally in conjunction with an exit tax, "I-E" provides an ongoing net of tax return with often no further individual taxation payable on policy proceeds.) Importantly, this "I-E" regime is also the one that still rules in Ireland's closest and much larger neighbor, the United Kingdom.

These differences and discriminatory tax regimes for domestic companies on the one hand and for IFSC companies (prohibited from writing local business) on the other

would always present conflicts from a structural EU perspective.

The 10% corporation tax issue was resolved by the Irish government in July 1998 when it announced a new unified 12.5% (yes – 12.5%!) corporation tax rate for all companies, IFSC and non-IFSC, from 2003. This changes involved a stepped reduction from the standard rate of 32% in 1998 to 12.5% over five years; the present 24% rate (year 2000) will reduce to 20% in 2001 and 16% in 2002 before reaching its 12.5% end level in 2003.

This move was announced simultaneously with the news that no new IFSC companies would be permitted after December 31, 1999. EU structural concerns were thereby placated.

The conflict of GRU versus "I-E" however still remained. The closure of the IFSC seemingly meant that GRU was no longer possible (for future start-ups), thus halting the influx of more cross-border life companies. Evidently, this would bring to an end the marketing of Ireland as a centre for cross-border EU life business — one of many initiatives that had led to a sustained economic boom (average GNP growth of over 8% pa since 1993) and "the Celtic Tiger" label. Or so it seemed ....

The Future

Fortunately, the Irish government had different ideas — which were far more advanced, for example, than the U.K. government's efforts for the EU expansion of its life assurance industry, which so far have foundered on the tax authorities' insistence on a heavy-handed, bureaucratic regime (to counter the fear of tax avoidance). (The U.K. regime has very recently been relaxed, but it is too early to judge the results.) Instead, in the Irish Budget on December 1, 1999, the Minister for Finance announced new life assurance taxation arrangements which would align the treatment of the domestic market and the IFSC market — *to those of the IFSC market*. Gross roll-up is therefore coming in across the board, in a move to break away from the UK "I-E" model in favor of adopting the European model.

The Legislative Detail

Under the Finance Act 2000, the new GRU arrangements come into effect for (existing) domestic life companies from January 1, 2001. More immediately, start-ups (domestic and international) as from April 1, 2000 may elect to immediately apply the "new basis business" GRU treatment. Existing business prior to January 1, 2001 is unaffected and remains on the "I-E" footing, although some domestic companies are already offering to convert existing policies to the new GRU basis (as from January 1, 2001).

Hand in hand with the new GRU regime comes a new exit tax. This exit tax, applied to the policy gain, is triggered by specific "chargeable events" (maturity, surrender, assignment, etc.) and will for Irish residents be levied at the standard rate of income tax (22%) plus 3%. (The 3% surcharge is an attempt to take account of the compound interest benefits arising from the tax deferral.) Crucially, though, this exit tax applies to Irish resident or ordinary resident policyholders. Thus, all business written by Irish life offices on non-resident policyholders will, from April 1, 2001 (at the latest), benefit from GRU with no exit charge. Non-Irish policyholders may still have a domestic tax liability on this gain, but nonetheless, the regime does maintain for such policyholders the possibility of tax deferral.

The Improved Attractions

In the new post-IFSC taxation regime, the attractions of Ireland as a HQ for cross-border European business are now even greater:

- Gross roll-up is now automatic, no longer conditional upon the IFSC tax certificate.
- The certainty of a 12.5% corporation tax rate in 2003 (backed up by a very extensive network of double taxation treaties).
- A modern, sensible regulatory approach which encourages modern and innovative products, minimizes bureaucracy and regulatory interference and relies upon the well-tried appointed actuary regime.
- Automatic EU single passport for cross-border services business throughout the European Economic Area (EEA) and right of establishment, underpinned by the Third Life Directive.
- Close proximity and ease of access to Ireland's closest and largest neighbor life assurance market — the United Kingdom
- The employment quota (previously a condition of the IFSC tax certificate, and typically 20 staff within the first three years of operation) does not apply to non-IFSC start-ups, so full labor and operational flexibility is now available.
- Furthermore, financial assistance from the IDA is now available for life company start-ups outside of Dublin — so "Ireland" no longer means "Dublin city centre" (costs).

One thing has not changed, however, and that is the fact that the EEA remains the largest single trading block in the developed world, with a combined population of 380 million and a GDP larger than that of the USA.

Ireland's future as a centre for international life assurance business in the next decade and beyond therefore looks assured.

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