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Technical Paper: **Tax Implications of IFRS 17**

TECHNICAL ADVISORY

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Abbreviations and Glossary of terms

Abbreviations	
CSM	Contractual Service Margin
FCF	Future Cash Flow
FSC	Financial Services Commission
GMM	General Measurement Model
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
LRC	Liability for Remaining Coverage
MRA	Modified Retrospective Approach
OCI	Other Comprehensive Income
PAA	Premium Allocation Approach
RAIC	Risk Adjustment on Initial Recognition
RMO	Risk Mitigation Option
TAJ	Tax Administration Jamaica
VFA	Variable Fee Approach

Glossary of Terms	
Contractual Service Margin	A component of the carrying amount of the asset or liability for a group of insurance contracts representing the unearned profit the entity will recognize as it provides insurance contract services under the insurance contracts in the group.
Fulfilment Cash Flows	An explicit, unbiased and probability-weighted estimate (ie expected value) of the present value of the future cash outflows minus the present value of the future cash inflows that will arise as the entity fulfils insurance contracts, including a risk adjustment for non-financial risk.

Initial Application Date	The date of initial application is the beginning of the annual reporting period in which an entity first applies IFRS 17 which is taken to be on or after 1 January 2023 unless there was early adoption..
Insurance Contract	contract under which one party (the issuer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.
Insurance Contract with Direct Participation Features	An insurance contract for which, at inception: (a) the contractual terms specify that the policyholder participates in a share of a clearly identified pool of underlying items; (b) the entity expects to pay to the policyholder an amount equal to a substantial share of the fair value returns on the underlying items; and (c) the entity expects a substantial proportion of any change in the amounts to be paid to the policyholder to vary with the change in fair value of the underlying items.
Insurance Risk	Risk, other than financial risk, transferred from the holder of a contract to the issuer.
Transition Date	The transition date is the beginning of the annual reporting period immediately preceding the date of initial application.
Tax Transitional Amount	The tax transitional amount is the amount allocated to a company's long-term life assurance business, designed to mitigate the tax effect of IFRS 17 adoption by treating a transitional amount as a receipt or expense of the life assurance business, spread evenly over a 10 year transitional period

Purpose

1. The purpose of this Technical Advisory is to provide guidance to internal stakeholders, financial regulators, issuers of insurance contracts, preparers of financial accounts and other stakeholders on the tax implications of the adoption of IFRS 17.

Objective

2. Tax Treatment of IFRS 17 seeks to ensure that stakeholders are fully aware of the general principles surrounding the adoption and application of IFRS 17 and the reporting requirements and tax computation rules required by TAJ.

Scope

3. This Technical Advisory applies to all insurance contracts that are recognized and measured under the IFRS 17 standard and issued by an insurance company regulated by the FSC. IFRS 17 will introduce new concepts central to the new insurance

accounting regime, which substantially change financial reporting for insurance and reinsurance companies, including:

a. life insurers – which includes annuity, accident and health insurance providers
b. property and casualty (P&C) insurers – which includes auto, personal property, commercial property, liability and title insurance providers

Legislative Reference

4. Income Tax Act

Section 2 Interpretations
Section 5 Chargeable income.
Section 12 Incomes exempt from income tax.
Section 15 Deductions not allowable
Section 30 Rates of income tax.
Section 48 Insurance, shipping and aircraft companies

Background

5. In March 2004 the International Accounting Standards Board (Board) issued IFRS 4 - Insurance Contracts. IFRS 4 was an interim standard which was meant to be in place until the Board completed its project on insurance contracts. IFRS 4 permitted entities to use a wide variety of accounting practices for insurance contracts, reflecting national accounting requirements and variations of those requirements, subject to limited improvements and specified disclosures.

6. In May 2017, the Board completed its project on insurance contracts with the issuance of IFRS 17 Insurance Contracts. IFRS 17 replaces IFRS 4 and sets out principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of IFRS 17. For the purposes of this advisory, the initial date of application of IFRS 17 is taken to be reporting periods beginning on or after January 1, 2023.

7. IFRS 17 Insurance Contracts establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of the Standard. The objective of IFRS 17 is to ensure that an entity provides relevant information that faithfully represents those contracts. This information gives a basis for users of financial statements to assess the effect that insurance contracts have on the entity's financial position, financial performance and cash flows.

8. The measurement of income from insurance contracts, particularly those that relate to life and other long-term insurance contracts is the single most important change under IFRS 17 for tax purposes. Traditionally accounting rules were developed around the collection and pooling of premiums, which are then invested to pay claims, often years after contracts are sold. Specific rules had to be developed regarding the computation of income for tax purposes. These special tax rules permit insurers to deduct actuarially computed policy reserves in advance of actual outflows, in recognition of the future claims that will be paid. Under IFRS 17, reserves will continue to be determined actuarially when insurance contracts are sold; however, IFRS 17 will introduce a new reserve, the contractual service margin (CSM), which will represent a portion of the profits on underwritten insurance contracts that is deferred and gradually released into income over the estimated life of the underlying group of insurance contracts.

Identifying Contracts within the scope of IFRS 17

9. An 'insurance contract' is defined in IFRS 17 as: A contract under which one party (the issuer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

10. An entity shall apply IFRS 17 to:
    a. insurance contracts, including reinsurance contracts, it issues;
    b. reinsurance contracts it holds; and
    c. investment contracts with discretionary participation features it issues, provided the entity also issues insurance contracts.

11. An entity shall not apply IFRS 17 to:
    (a) warranties provided by a manufacturer, dealer or retailer in connection with the sale of its goods or services to a customer
    (b) employers' assets and liabilities from employee benefit plans and retirement benefit obligations reported by defined benefit retirement plans.
    (c) contractual rights or contractual obligations contingent on the future use of, or the right to use, a non-financial item (for example, some license fees, royalties, variable and other contingent lease payments and similar items.
    (d) residual value guarantees provided by a manufacturer, dealer or retailer and a lessee's residual value guarantees when they are embedded in a lease.
    (e) financial guarantee contracts, unless the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts. Financial guarantee contracts transfer significant insurance risk and typically meet the definition of an insurance contract. With the replacement of IFRS 4 Insurance Contracts by IFRS 17 Insurance Contracts, the accounting for these contracts may change significantly. The impact on the financial statements will differ depending on whether a company applies IFRS 17 or IFRS 9. For the purposes of consistency, uniformity and comparability, it is recommended that the FSC makes

a determination on the applicable standard to be applied by regulated entities in Jamaica.

(f) contingent consideration payable or receivable in a business combination

(g) insurance contracts in which the entity is the policyholder, unless those contracts are reinsurance contracts held.

(h) credit card contracts, or similar contracts that provide credit or payment arrangements, that meet the definition of an insurance contract if, and only if, the entity does not reflect an assessment of the insurance risk associated with an individual customer in setting the price of the contract with that customer (see IFRS 9 and other applicable IFRS Standards). However, if, and only if, IFRS 9 requires an entity to separate an insurance coverage component that is embedded in such a contract, the entity shall apply IFRS 17 to that component.

Examples of insurance contracts

12. The following are examples of contracts that are insurance contracts if the transfer of insurance risk is significant:
    a. insurance against theft or damage.
    b. insurance against product liability, professional liability, civil liability or legal expenses.
    c. life insurance and prepaid funeral plans (although death is certain, it is uncertain when death will occur or, for some types of life insurance, whether death will occur within the period covered by the insurance).
    d. life-contingent annuities and pensions, i.e. contracts that provide compensation for the uncertain future event—the survival of the annuitant or pensioner—to provide the annuitant or pensioner with a level of income that would otherwise be adversely affected by his or her survival.
    e. insurance against disability and medical costs.
    f. surety bonds, fidelity bonds, performance bonds and bid bonds, i.e. contracts that compensate the holder if another party fails to perform a contractual obligation; for example, an obligation to construct a building.
    g. product warranties. Product warranties issued by another party for goods sold by a manufacturer, dealer or retailer are within the scope of IFRS 17.
    h. title insurance (insurance against the discovery of defects in the title to land or buildings that were not apparent when the insurance contract was issued). In this case, the insured event is the discovery of a defect in the title, not the defect itself.
    i. travel insurance (compensation in cash or in kind to policyholders for losses suffered in advance of, or during, travel).
    j. catastrophe bonds that provide for reduced payments of principal, interest or both, if a specified event adversely affects the issuer of the bond (unless the specified event does not create significant insurance risk; for example, if the event is a change in an interest rate or a foreign exchange rate).

k. insurance swaps and other contracts that require a payment depending on changes in climatic, geological or other physical variables that are specific to a party to the contract.

Items that are not insurance contracts:

13. The following are examples of contracts that are insurance contracts if the transfer of insurance risk is significant:

(a) investment contracts that have the legal form of an insurance contract but do not transfer significant insurance risk to the issuer. For example, life insurance contracts in which the entity bears no significant mortality or morbidity risk are not insurance contracts; such contracts are financial instruments or service contracts. Investment contracts with discretionary participation features do not meet the definition of an insurance contract; however, they are within the scope of IFRS 17 provided they are issued by an entity that also issues insurance contracts;

(b) contracts that have the legal form of insurance, but return all significant insurance risk to the policyholder through non-cancellable and enforceable mechanisms that adjust future payments by the policyholder to the issuer as a direct result of insured losses. For example, some financial reinsurance contracts or some group contracts return all significant insurance risk to the policyholders; such contracts are normally financial instruments or service contracts.

(c) self-insurance (i.e. retaining a risk that could have been covered by insurance). In such situations, there is no insurance contract because there is no agreement with another party. Thus, if an entity issues an insurance contract to its parent, subsidiary or fellow subsidiary, there is no insurance contract in the consolidated financial statements because there is no contract with another party. However, for the individual or separate financial statements of the issuer or holder, there is an insurance contract.

(d) contracts (such as gambling contracts) that require a payment if a specified uncertain future event occurs, but do not require, as a contractual precondition for payment, the event to adversely affect the policyholder. However, this does not exclude from the definition of an insurance contract contracts that specify a predetermined payout to quantify the loss caused by a specified event such as a death or an accident.

(e) derivatives that expose a party to financial risk but not insurance risk, because the derivatives require that party to make (or give them the right to receive) payment solely based on the changes in one or more of a specified interest rate, a financial instrument price, a commodity price, a foreign exchange rate, an index of prices or rates, a credit rating or a credit index or any other variable, provided that, in the case of a non-financial variable, the variable is not specific to a party to the contract.

(f) credit-related guarantees that require payments even if the holder has not incurred a loss on the failure of the debtor to make payments when due; such contracts are accounted for by applying IFRS 9 Financial Instruments.

(g) contracts that require a payment that depends on a climatic, geological or any other physical variable not specific to a party to the contract (commonly described as weather derivatives).

(h) contracts that provide for reduced payments of principal, interest or both, that depend on a climatic, geological or any other physical variable, the effect of which is not specific to a party to the contract (commonly referred to as catastrophe bonds).

Recognition and Measurement of Insurance Contracts

14. The standard requires a company to measure insurance contracts using updated estimates and assumptions that reflect the timing of cash flows and any uncertainty relating to insurance contracts. The first step is to determine the type of insurance contract you're dealing with. IFRS 17 categorizes contracts into two main categories: insurance contracts that transfer significant insurance risk and investment contracts. IFRS defines insurance risk as anything that is not a financial risk, transferred from the holder of a contract to the issuer.

15. A Financial Risk is defined as: the risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, currency exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract.

16. Insurance risk is significant if, and only if, an insured event could cause the issuer to pay additional amounts that are significant in any single scenario, excluding scenarios that have no commercial substance. A significant insurance risk can exist even if the insured event is extremely unlikely or the expected present value of the contingent cash flows is a small proportion of the expected present value of the remaining cash flows from the insurance contract.

Investment contracts with discretionary participation features

17. An investment contract with discretionary participation features does not include a transfer of significant insurance risk. Consequently, the requirements in IFRS 17 for insurance contracts are modified for investment contracts with discretionary participation features as follows:
(a) the date of initial recognition is the date the entity becomes party to the contract.
(b) the contract boundary is modified so that cash flows are within the contract boundary if they result from a substantive obligation of the entity to deliver cash at a present or future date. The entity has no substantive obligation to deliver cash if it has the practical

ability to set a price for the promise to deliver the cash that fully reflects the amount of cash promised and related risks.
(c) the allocation of the contractual service margin is modified so that the entity shall recognize the contractual service margin over the duration of the group of contracts in a systematic way that reflects the transfer of investment services under the contract.

18. In the context of insurance contracts, the contract boundary is defined as "the point at which an insurer has no further obligation to provide coverage to the policyholder". The contract boundary for an insurance contract under IFRS 17 determines which cash flows should be included within the fulfilment cash flows, and hence the value of the CSM.

19. There are three models for accounting for insurance contracts in IFRS 17, being:
• The General Measurement Model (GMM).
• The Premium Allocation Approach (PAA).
• The Variable Fee Approach (VFA).

20. General Measurement Model/Approach: The General Measurement Model (GMM) is the standard approach to calculate/estimate liabilities for the insurance contract under IFRS 17. This model focuses on providing key information on the expected cash flows and profitability of the insurance contracts. In terms of applicability, the GMM is applicable to contracts with longer terms. Under this model, insurance liabilities are measured as the present value of future cash flows, which include expected future cash flows from fulfilling the contract, risk adjustments, and contractual service margin (CSM).

The GMM under IFRS 17 involves several key steps:

21. Identifying Insurance Contracts:
The first step is to identify the contracts that fall under the scope of IFRS 17. Insurance contracts are defined as agreements between an insurer and a policyholder, where the insurer agrees to provide compensation for specified events (insured risks) in exchange for consideration (premiums).

22. Measurement Models:
Fulfillment Cash Flows:
Insurance contracts are measured based on the "fulfillment cash flows," which represent the present value of all future cash flows that will arise as the insurer fulfills its obligations under the contract. This includes both cash inflows (premiums) and outflows (claims, expenses, etc.).

23. Contractual Service Margin (CSM):
The CSM represents the unearned profit that the insurer will recognize over the life of the contract. It's the difference between the fulfillment cash flows and the risk-adjusted present value of future cash flows.

24. Risk Adjustment:
A risk adjustment is required in the measurement of fulfillment cash flows to account for the uncertainty inherent in insurance contracts. The risk adjustment reflects the compensation the insurer requires for bearing the uncertainty and fulfilling the contractual obligations.

25. Discounting:
The fulfillment cash flows and the CSM are discounted to present value using a discount rate that reflects the characteristics of the insurance contract. This rate should be consistent with the rate used to measure the fulfillment cash flows.

26. Subsequent Measurement:
At each reporting period, insurers reassess and update their estimates of fulfillment cash flows, risk adjustments, and discount rates. Changes in these estimates impact the recognition of profit or loss and the adjustment of the CSM.

27. The Premium Allocation Approach (PAA) is one of the methods prescribed for recognizing and reporting insurance contract revenue and expenses. This approach is applicable to insurance contracts that are considered to provide coverage over a period of time. Under the PAA, insurance revenue is recognized in a systematic manner over the coverage period of the insurance contract, and the related insurance liabilities are updated accordingly.

28. The steps of the PAA are as follows:

- **Initial Recognition**
  When an insurance contract is issued, the insurer recognizes a contractual service margin (CSM) that represents the unearned profit on the contract.

- **Revenue Recognition**
  Over the coverage period of the contract, a portion of the CSM is recognized as insurance revenue in each reporting period. This revenue recognition is based on the pattern of coverage provided by the insurance contract.

- **Expense Recognition**
  Corresponding expenses related to fulfilling the insurance contract are also recognized over the coverage period. The expense recognition is aligned with the recognition of insurance revenue.

- **Updates to CSM**
  At the end of each reporting period, the CSM is updated to reflect changes in estimates of future cash flows, claims, and expenses. This ensures that the recognition of revenue and expenses accurately reflects the insurer's expectations.

The Variable Fee Approach (VFA)

29. The VFA applies to insurance contracts with direct participation features, often associated with participating or with-profit contracts. These contracts provide policyholders with a share in the returns earned by the insurance company's underlying assets. The Variable Fee Approach is used to determine the portion of the contractual cash flows that represent the returns on underlying items and attribute them appropriately.

The steps of the VFA are as follows:

30. Identify Contracts with Participating Features:
Insurance contracts that participate in the returns of underlying items (such as investment funds or portfolios) and have variability in the cash flows based on these returns fall under the scope of the VFA. These contracts are commonly found in life insurance and annuity products.

31. Identify Underlying Items:
The insurer needs to identify the underlying items that generate returns, such as investment assets held to back the participating contracts. These could include bonds, equities, real estate, etc.

32. Determine the Variable Fee:
The variable fee is the portion of the contractual cash flows that is attributed to the returns on the underlying items. It represents the compensation the policyholders receive for participating in the investment performance. This fee is calculated as a residual after other cash flows have been accounted for.

33. Allocate the Variable Fee:
The variable fee is then allocated between the insurance contract liability and a separate performance statement. The allocation is based on the extent of the insurance coverage provided by the contract.

34. Recognize in Financial Statements:
The portion of the variable fee that's allocated to the insurance contract liability is recognized as part of the contractual service margin (CSM). The CSM is subsequently recognized in the income statement as the insurance contract is fulfilled.

35. Performance Statement:
The portion of the variable fee that's allocated to the performance statement is recognized immediately in the income statement as revenue. This reflects the investment return component that the insurer retains.

36. The VFA aims to appropriately reflect the investment return component in both the insurance contract liability and the income statement. The allocation process ensures that policyholders receive a fair share of the investment returns, while the insurer's retained portion is recognized as revenue.

Contractual Service Margins

37. Under IFRS 17, an amount of the CSM for a group of insurance contracts is recognized in profit or loss in each period to reflect the profit earned for insurance contract services provided under the group of insurance contracts in that period. The CSM represents the unearned profit that an entity expects to earn as it provides services. This represents the unearned profit that will be recognized over the coverage period. It is calculated as the difference between the carrying amount of the liability and the present value of expected future cash flows.

38. Insurance Revenue: Revenue is recognized over the coverage period as services are provided to the policyholders. This includes the portion of CSM that is recognized as profit in the income statement.

39. Insurance Expenses: These include the costs associated with providing insurance coverage, such as claims, acquisition costs, and administrative expenses.

40. Changes in Estimates:
Changes in estimates, such as changes in expected cash flows or discount rates, can lead to adjustments in the liability and the CSM, which in turn affect profit or loss.

41. Reassessment and Updates:
The contract liabilities and CSM are reassessed and updated at the end of each reporting period to reflect the current estimates and any changes that have occurred.

Transitional Provisions

42. The standard includes specific transitional provisions for contracts existing at the adoption date, allowing entities to determine the impact of IFRS 17 on their opening balances.

The Retrospective Approach

43. The retrospective approach refers to a method of applying the standard to insurance contracts that existed prior to January 1, 2023 or the beginning of the permitted accounting period if later than January 1, and reported under a previous accounting standard. It involves restating the comparative figures presented in the financial statements for prior periods as if IFRS 17 had always been applied. This approach provides a consistent view of financial performance and position over time. IFRS 17 requires entities to restate fully retrospectively unless impracticable.

Steps in applying the retrospective approach:

44. Determining the transition date:

The transition date of IFRS 17 is the beginning of the annual reporting period immediately preceding the date of initial application. For example, for a company applying IFRS 17 from January 1, 2023, the transition date is January 1, 2022.

45. Contracts in scope:
Identifying all contracts which transfer significant insurance risk and meet the definition of an insurance contract as defined by IFRS 17.

46. Restatement of Comparative Information:
For the reporting period that includes the transition date, the entity restates the comparative figures presented in the financial statements of prior periods as if IFRS 17 had always been applied. This means adjusting the opening balances of assets, liabilities, equity, and related items based on the principles of IFRS 17.

47. Adjustments for Re-measurement and Recognition:
Under the retrospective approach, adjustments are made for the re-measurement of insurance liabilities and any changes in recognition that result from the application of IFRS 17. This includes revising the calculation of contractual service margins (CSM), liability for remaining coverage, and other related items.

48. The retrospective approach aims to provide users of financial statements with a comprehensive view of how the application of IFRS 17 impacts the company's financial performance and position over time. It helps ensure comparability between different reporting periods and provides transparency about the effects of transitioning to the new standard.

49. If it is not practicable to retrospectively apply the requirements of IFRS 17, two alternative approaches are available:
    - The modified retrospective approach.
    - The fair value approach.

What is impracticable?

50. The concept of impracticability of applying requirements of accounting standards is set out in IAS 8 paragraph 5. Specifically, IAS 8 defines impracticability scenarios where the entity cannot apply a requirement after making every reasonable effort to do so. It then goes on to set out some of the scenarios where retrospective application may be impracticable.

51. The IASB concluded that the following amounts needed for retrospective application would often (though not always) be impracticable:
    - the estimates of cash flows at the date of initial recognition;
    - the risk adjustment for non-financial risk at the date of initial recognition;
    - the changes in estimates that would have been recognized in profit or loss for each accounting period because they did not relate to future service, and the extent to which changes in the fulfilment cash flows would have been allocated to the loss component;
    - the discount rates at the date of initial recognition; and

• the effect of changes in discount rates on estimates of future cash flows for contracts for which changes in financial assumptions have a substantial effect on the amounts paid to policyholders.

Fair value approach

52. To apply the fair value approach, an entity shall determine the contractual service margin or loss component of the liability for remaining coverage at the transition date as the difference between the fair value of a group of insurance contracts at that date and the fulfilment cash flows measured at that date. The fair value approach is the only approach that can be used where the insurer does not have the cash flow information needed to apply other approaches. An entity can elect to use the fair value approach if the full retrospective approach is impracticable, and it is required to use the fair value approach if the modified retrospective approach is impracticable.

53. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. On the other hand, fulfilment cash flows are the present value of the cash flows that an entity expects to derive from the continuing use of an asset and its ultimate disposal.

Modified Retrospective Approach

54. The Modified Retrospective Approach (MRA) is one of the three approaches that can be used to determine the Contractual Service Margin (CSM) at the transition date under IFRS 17. The MRA is intended to offer a method that maintains comparability of results, while recognizing that companies will often lack data for a full retrospective calculation. The objective of the MRA is to achieve the closest outcome to retrospective application as possible using reasonable and supportable information available without undue cost or effort. This is achieved through specific modifications to a full retrospective calculation which provides for the restating of all prior periods, as set out in the standard.

55. For contracts following the General Measurement Model, specific modifications are available in a number of areas, including estimates of future cash flows, calculation of the risk adjustment, setting of the discount rate, amortization of the CSM and other areas. The MRA also allows for grouping of annual cohorts, where there isn't sufficient data to perform a retrospective calculation at this level.

56. The concept of cohort grouping requires, an entity to group contracts with similar characteristics into a unit. Instead of restating each individual insurance contract, an entity can group contracts with similar characteristics into cohorts. These cohorts might be defined based on factors like product type, geography, contract issue date, or other relevant criteria. The MRA allows entities to use simplified methods for obtaining historical data related to insurance contracts. This is especially beneficial when detailed historical data might not be readily available for all contracts.

57. Similar to the general concept of the MRA in accounting, under IFRS 17, the cumulative effect of applying the standard is recognized as an adjustment to the retained earnings at

the date of transition. The transition date is the period immediately preceding the period of first application of the standard. In this case the transition date is January 1, 2022 based on an application date of January 2023. This means that the financial statements as of the beginning of the first reporting period when IFRS 17 is applied reflects the restated retained earnings.

58. It's important to note that while the MRA offers simplifications, it still requires careful consideration and documentation to ensure that the approach is applied correctly and consistently. Entities that choose to use the MRA must disclose information about the transition approach and its impact on their financial statements.

59. There is a requirement to use as few modifications as necessary, which means companies will need to demonstrate for each modification used that a full retrospective approach is impracticable. If a full retrospective calculation is impracticable, then companies face a free choice between the MRA and the fair value approach, for each group of insurance contracts. If the MRA is impracticable, companies must use the fair value approach by default.

60. A hierarchy of the application of the MRA is shown below. These modifications provide relief from the requirements of the full retrospective approach where required, and act as a proxy for that approach.

61. IFRS 17 allows for a modified retrospective approach, where an entity applies certain practical expedients when restating prior periods. These practical expedients can simplify the application of the standard while still achieving a consistent presentation. However, these expedients should be carefully evaluated based on their appropriateness for the entity's circumstances.

The key practical expedients available under the modified retrospective approach are:

62. Use of Risk Mitigation Option (RMO) for Contracts with Direct Participation Features:
IFRS 17 requires separating insurance and investment components in certain contracts. The practical expedient allows an entity to use the Risk Mitigation Option (RMO) for certain contracts with direct participation features. The RMO simplifies the measurement of the insurance liability by allowing an entity to measure the liability for insurance coverage at a simplified amount, excluding the investment components.

63. Use of the Premium Allocation Approach (PAA) for Insurance Contracts with Short Coverage Periods:
The Premium Allocation Approach (PAA) is a simplified method of measuring the liability for remaining coverage for certain short-term contracts. The practical expedient allows an entity to use the PAA for insurance contracts that have coverage periods of one year or less and meet certain criteria.

64. Use of the Variable Fee Approach (VFA) for Investment Contracts with Discretionary Participation Features:

The Variable Fee Approach (VFA) is used to determine the contractual service margin (CSM) for investment contracts with discretionary participation features. The practical expedient allows an entity to apply the VFA to these contracts, simplifying the calculation of CSM.

65. Separate Presentation of Insurance and Investment Components:
IFRS 17 requires entities to separate insurance and investment components in certain contracts. The practical expedient allows an entity to present these components as a single amount in the financial statements, provided certain conditions are met.

66. Use of Risk Adjustment on Initial Recognition (RAIC):
The Risk Adjustment on Initial Recognition (RAIC) is used to measure the liability for remaining coverage for certain short-duration contracts. The practical expedient allows an entity to use RAIC for insurance contracts that have a coverage period of one year or less.

67. Contract Boundary Approach for Group of Contracts:
IFRS 17 defines the contract boundary and requires the identification of distinct groups of insurance contracts. The practical expedient allows an entity to use a simplified approach for determining the contract boundary for a group of insurance contracts that share similar risks and characteristics.

68. These practical expedients aim to simplify the application of IFRS 17 and reduce the complexity of transition, particularly for contracts with unique features or characteristics.

Tax Transitional Amount

69. Entities that offer life insurance contracts will have a large one-off transitional amount arising from the adoption IFRS 17. In order to mitigate the revenue risk to the consolidated fund, a decision has been taken to spread the transitional impact of IFRS 17 for the long-term business of life insurers over a 10-year period, beginning with the first day of the first accounting period in which accounts are prepared based on IFRS 17 (January 1, 2023). During our stakeholder consultations, representations were made that the change in the measurement of revenue and the ultimate determination of profits, may result in profits being subject to corporation tax twice. The effective date for the spread of the tax transitional amount is January 1, 2023 or the first day of the permitted accounting period beginning in 2023 over a 10-year period.

70. In order to address the above, the “tax transitional amount” that would have been subject to tax in prior periods, would have to be determined. Assuming a January 1, 2023 initial application date, the accumulated profits less any accumulated losses as at December 31, 2022 determined under the IFRS 4 accounting rules (Old “O”) must be compared with the accumulated profits less any accumulated losses as at December 31, 2022, restated in accordance with IFRS 17 rules (New “N”).

71. The restated amount “N” will form part of the comparative 2022 balances in the statement of financial position for the accounting year beginning on or after January 1,

2023, prepared in accordance with IFRS 17 standards. Both the closing balances of accumulated profits less accumulated losses in the first IFRS 17 statement of financial position "N" and pre-IFRS 17 statement of financial position "O" are subject to any adjustments in order to arrive at chargeable income pursuant to the Income Tax Act.

Following these adjustments, the pre-IFRS 17 closing balance ("O") is deducted from the IFRS 17 closing balance ("N"). **The formula for the Tax Transitional Amount = N – O**.

72. Amounts which do not solely relate to the adoption of IFRS 17, are excluded from the tax transitional amount. Amounts relating to businesses other than the long-term life assurance business, on the date of the initial application of IFRS 17 must be excluded. The amount recognized as the Tax Transitional Amount must not relate to insurance contracts that have matured, expired or derecognized prior to the date of initial application of IFRS 17.

73. Depending on whether the IFRS 17 tax transitional amount is a positive or negative figure, it is treated as either a receipt or expense of the business respectively in determining the chargeable income. The receipt or expense is then spread equally over 10 years and taken into account in calculating the chargeable income in each accounting period beginning on or after 1 January 2023 or the first accounting period in which IFRS 17 is adopted if later.

74. The spreading of the tax transitional amount does not apply to general insurance contracts utilizing the premium allocation approach. Multiyear general insurance contracts will be required to spread any tax transitional amount over the life of the contract.

75. Unrealized losses on onerous contracts that is included in any accumulated profits or losses used in the computation of the tax transitional amount, must be removed. The losses on onerous contracts are claimable when they are realized.

The Contractual Service Margin and Computation

76. The Contractual Service Margin (CSM) is a key concept in IFRS 17. It represents the unearned profit that an insurance company will recognize as revenue over the coverage period of an insurance contract. The CSM is calculated as the present value of the future profits that are expected to arise as the insurance company fulfills its obligations under the contract.

The Contractual Service Margin (CSM) is computed as follows:

77. Initial Measurement:
When an insurance contract is initially recognized, the company calculates the present value of expected future cash flows. These cash flows include expected claim payments, expenses, and future cash inflows from premiums and investment income.

78. Estimation of Future Cash Flows:

The estimation of future cash flows involves considering various factors such as claims experience, investment returns, policyholder behavior (lapse rates, surrender rates, etc.), and other relevant assumptions.

79. Discounting of Cash Flows:
The estimated future cash flows are then discounted to present value using an appropriate discount rate. The discount rate typically reflects the time value of money and the risk associated with the cash flows.

80. Calculation of the Liability for Remaining Coverage (LRC):
The present value of expected future cash flows represents the liability for remaining coverage (LRC) under the insurance contract. This liability includes the amount needed to fulfill the obligations to policyholders over the coverage period.

81. Calculation of the CSM:
The Contractual Service Margin (CSM) is calculated as the difference between the liability for remaining coverage (LRC) and the present value of expected future cash flows. Mathematically, CSM = LRC – PV (Future Cash Flows).

82. Recognition of Profit:
As the company provides services and fulfills its obligations under the insurance contract, the CSM is gradually recognized as profit in the income statement over the coverage period. The amount of CSM recognized as revenue each reporting period is determined by the proportion of services provided to the policyholders.

83. The Contractual Service Margin (CSM) ensures that an insurance company recognizes profit over the coverage period in a systematic and rational manner. It reflects the unearned portion of profit that is attributable to the future coverage and services provided under the contract. The process of recognizing the CSM as revenue helps to align the recognition of profit with the actual services provided to policyholders over time.

The Tax Regime

Life Assurance Companies

84. Life assurance companies will be allowed to determine tax profits/losses based on IFRS 17 standards, subject to adjustments required under the income tax act and this technical advisory.

85. A Life Assurance Company is an entity offering life assurance policies by way of an agreement between a policyholder and itself, in return for a payment (premium) from the

policyholder, the company commits to pay someone or something (the beneficiary) upon the death of the person whose life is being covered (the life assured).

86. The current regime imposes a *Corporate Income Tax rate of 25% effective year of assessment 2015 for Life Assurance Companies*. Section 5 of the Income Tax Act was amended to tax life assurance companies, whether mutual or proprietary, on all income, profits or gains including any reduction in the actuarial reserves.

87. Section 12 was amended to exempt from Income Tax, premiums received by a life assurance company as—
    a. contributions to approved superannuation funds or approved retirement schemes;
    b. payment in respect of annuities purchased from the company by any such fund or scheme; or
    (c) any amounts or earnings arising from the investment of any funds derived from the
    sale of the annuities and deposited in a separate account established solely for that purpose.

88. Section 15 was amended to disallow:
    (a) expenses incurred for considerations received for annuities in relation to a life assurance company
    (b) premiums received by a life assurance company as contributions to approved superannuation funds or approved retirement schemes;
    (c) payment in respect of annuities purchased from the company by an approved superannuation funds or approved retirement schemes;

89. Section 30 was amended to impose corporate income tax of 25% on the chargeable income of every life assurance company.

Treatment of Annuities for Tax Purposes

90. An Annuity usually refers to a retirement account into which contributions are made during the working life of the individual /annuitant on a monthly basis or as a one-time contribution. This insurance product facilitates long term savings for retirement and features a predetermined periodic pay-out amount until the death of the annuitant. On retirement, the annuitant receives periodic (usually monthly) payments, providing a reliable source of income. This income is based on the principal plus investment income earned on the contributions that are invested by the insurance company. When a triggering event (such as death) occurs, the periodic payments from the annuity usually cease.

91. Section 12, the exemption section of the Income Tax Act was amended to include total Annuity Income and section 15 – Deductions not allowable was amended to exclude total expenses related to and incurred in earning Annuity income
92. The provisions of the income tax act pertaining to the taxation of annuities will continue.

General Insurance Companies

93. General Insurance companies will be allowed to determine tax profits/losses based on IFRS 17 standards, subject to adjustments required under the income tax act and this technical advisory.

94. The general model should be applied as a default model for the measurement of all insurance liability. General model comprises of best estimate future cash flows under contract boundaries, discounting, risk adjustment, and contractual service margin. IFRS 17 allows insurers to use premium allocation approach as a simpler method, subject to eligibility. A group is eligible for the premium allocation approach (PAA) if:

a) Each contract in the group has a coverage period of one year or less; or

b) Measurement of the liability for remaining coverage for the group using the premium allocation approach is reasonably expected to produce a measurement of the liability for remaining coverage which is not materially different from using the general model.

To the extent that General Insurers sells multiyear contracts, eligibility for the premium allocation approach must be determined. The PAA is only applicable where it is expected to produce a measurement of the liability that would not differ materially from the General Model. To the extent that a contract qualifies for the PAA, there is no requirement to compute the contractual service margin (CSM). However, where the general model is applicable and the contract period involves multiple years, the CSM computed at the initial application of the standard must be spread over the life of the contract.

Other Comprehensive Income (OCI)

95. Other comprehensive income includes items that are not recognized in the income statement but are instead presented separately in the statement of comprehensive income. These items represent gains, losses, income, and expenses that bypass the traditional income statement but are still important for reflecting changes in the financial position of an entity. IFRS 17 permits an entity to choose to present insurance finance income or expenses either in profit or loss or disaggregated between profit or loss and OCI. The choice is made on a portfolio-by-portfolio basis.

96. Typical components of OCI income may include:

- Foreign Currency Translation Adjustments: Changes in the value of foreign subsidiaries' net assets due to fluctuations in exchange rates.

- Unrealized Gains or Losses on Available-for-Sale Investments: Changes in the fair value of certain investments that are not classified as trading securities.

- Actuarial Gains or Losses on Defined Benefit Pension Plans: Changes in the value of pension plan obligations due to changes in assumptions or market conditions.

- Cash Flow Hedges: Gains or losses from derivative instruments used to hedge cash flow variability.

- Revaluation of Property, Plant, and Equipment: Changes in the value of certain assets due to revaluations.

97. It is the view of TAJ that in certain circumstances IFRS 17 accounting entries could be recognized in Other Comprehensive Income (OCI) and not transferred to profit or loss. Where an insurance contract matures, expires or is derecognized in a period of account, any amounts remaining in OCI relating to such contract, must be accounted for as part of the taxable income of the entity.

Onerous contracts

98. An insurance contract is onerous at the date of initial recognition if the fulfilment cash flows allocated to the contract, any previously recognized insurance acquisition cash flows and any cash flows arising from the contract at the date of initial recognition in total are a net outflow. An entity shall group onerous contracts separately from contracts that are not onerous.

99. If an entity has reasonable and supportable information to conclude that a set of contracts will all be in the same group, it may measure the set of contracts to determine if the contracts are onerous rather than individual contracts. An entity shall recognize a loss in profit or loss for the net outflow for the group of onerous contracts, resulting in the carrying amount of the liability for the group being equal to the fulfilment cash flows and the contractual service margin of the group being zero.

100. On subsequent measurement, if a group of insurance contracts becomes onerous (or more onerous), that excess shall be recognized in profit or loss. Additionally, the CSM cannot increase and no revenue can be recognized, until the onerous amount previously recognized has been reversed in profit or loss as part of a service expense. However, no corresponding gains are recognised in profit or loss if the losses are covered by reinsurance contracts recognised at the same time.
101. IFRS 17 may result in the issuer recognising a loss in respect to the onerous insurance contracts before the coverage period commences, or before the first premium due from the policyholder is paid.

- For the purposes of taxation, TAJ does not recognize unrealized losses, and therefore any expected loss arising from onerous contracts recognized in the profit and loss account, must be reversed for the purposes of computing chargeable income and the application of income tax. However, losses on onerous contracts will be allowed for tax purposes where the premium allocation approach (PAA) is used and the contract period is for one year contracts or less
  102.

Conclusion

103. Effective January 1, 2023 the IFRS 17 accounting standard is applicable in determining the net profit or loss subject to adjustments in the Income Tax Act and rules outlined in this technical advisory to arrive at chargeable income or estimated chargeable income. In relation to companies with permitted accounting periods, the standard applies to accounting periods beginning after January 1, 2023. This rule relates to all insurance contracts issued by an insurance company regulated by the FSC. Non-regulated entities issuing insurance contracts does not come within the scope of this advisory.