Reinsurance business seeks direct tax assurance

JANUARY 27, 2021

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INSURANCE industry has always been on the forefront in providing protection to human life and minimising financial losses in case of any uncertain events. It thus plays a pivotal role to aid economic activity and development. Life insurance provides protection in case of untimely and unfortunate event of death and also enables savings through retirement and pension products. General insurance, on the other hand, protects the health and wealth of citizens and businesses against various unforeseen events for e.g., fire, burglary, natural calamities, various liabilities, loss of profit and transport accidents, etc.

With the entire world facing an unpredictable and unprecedented situation due to the Covid-19 pandemic, human life is exposed to uncertainties and resultant risks from those uncertainties. In such difficult times, people have felt the need to protect their lives as well as that of their assets against such uncertain events. Life and general insurance companies offer support in such times, for many across the globe, including India.

While, life and general insurance companies are on the forefront, they have been duly supported at the backend by ***"Reinsurance companies"***, which are typically unknown to the primary insured. As the name suggests, reinsurance is an insurance of the insurance companies - i.e. a reinsurance company in turn assumes/underwrites life or general insurance company's risk portfolio in an effort to balance the likelihood of large payouts for a claim. Thus, reinsurance business also plays a critical role in the insurance industry, as it helps maintain the solvency ratio/ balance of primary insurers. The total reinsurance business in India in 2019 was around Rs. 50,000 crores. Considering the vital role of reinsurance, and to promote onshore underwriting of reinsurance contracts, the Insurance Regulatory and Development Authority of India (IRDAI) in 2015 opened doors for foreign reinsurance companies to enter the Indian insurance sector, leading to several global majors setting up branches in India.

Presently, there are 24 life insurance companies and 34 non-life insurance (general) companies in India. For several decades, General Insurance Corporation of India (GIC Re) was mainly the reinsurance company in India, for both life and general insurance business, with which mandatorily insurance companies had to reinsure certain percentage of their business. However, at present there are 10 branches of foreign reinsurance entities in India.

Current scheme of direct tax for foreign reinsurance branches

While, conducive regulatory framework changes were made under the insurance laws for foreign reinsurance companies, the income-tax law has largely remained unchanged. The Income-tax Act, 1961 (the Act) provides for a special tax regime for taxation of profits/loss of insurance business in India. It provides for specific rules for determining the profit/loss earned from life and other insurance businesses. However, it does not provide any specific/ separate provision for taxation of reinsurance business which deals with both life and non-life business. **Hence, a question arises as to whether reinsurance companies are required to adopt the rule prescribed for life insurance or the one prescribed for general insurance or both in parts.**

In the absence of reliable data, the Rules do provide for a generic mechanism to determine profits of branch office in India of non-residents carrying on any business of insurance, based on proportionality of global profits. Like the life and general insurance companies in India, the reinsurance branches of foreign entities are also strictly regulated and supervised by the IRDAI. These branch offices are also liable for compliances under the Companies Act, 2013. In other words, the branch offices have appropriate data of their financial activities in India and also maintain proper books of account as per IRDAI guidelines. Thus, the generic mechanism of computing proportionate profits becomes practically redundant for such branches.

The Act provides for a lower tax rate of 12.5% (plus applicable surcharge and cess) for life insurance business and an option to avail lower tax rate of 22% (plus 10% surcharge and 4% cess) for general insurance companies. Whereas, a 40% (plus surcharge and cess) rate is applied to the foreign reinsurance branches.

In India, Minimum Alternate Tax (MAT) is applicable if tax under the normal provisions of the Act is lower than the tax on book profits. However, MAT provisions are not applicable on any income accruing or arising to a company fromÂ life insuranceÂ business.

Thus, to summarise, income earned from life insurance business is computed differently wherein tax rate of 12.5% is applied on such income and MAT provisions are not attracted on such income.

The term reinsurance under the IRDA regulations is a hyphenated word ***"re-insurance"***
which could mean that it is re-insuring the insurance business. The IRDA Act, 1938 defines life insurance business and general insurance business but there is no specific definition of re-insurance business. Thus, if the re-insurance companies provide re-insurance for only life insurance business, would the rules to compute the profits and the rate of tax as applicable to life insurance business apply to them as well? The accounts of reinsurance business are generally not prepared on the same basis as what is reinsured and there is no bifurcation between life and other insurance business. In order to remove any ambiguity surrounding the taxation of reinsurance branches in India, and bring certainty, the
Act may be modified to provide for a specific/ separate rule, providing the mechanism for taxing profits from reinsurance business in India
. Alternatively, a clarification may be issued as to which rule from the special scheme of taxation prescribed for insurance should be adopted, especially for those reinsurance businesses that cater to life insurance business. In addition, concessional rate of tax of 12.5% / 22%, as in the case of insurance business, should be extended to reinsurance business, considering its distinctive nature and significant role played in the insurance industry, as against the existing high tax rate of 40% applied on foreign reinsurance branches operating in India. Separately, given the long gestation period of insurance and reinsurance business, the limit of eight years for carry forward and set-off of tax losses may be lifted for reinsurance business.

The government, in the recent past, has shown its inclination in supporting and further developing the insurance sector in India. Thus, with an endeavor for further developing and deepening the insurance business in India, an impetus to reinsurance sector through certainty in direct tax provisions and relaxations would go a long way in countering the huge losses incurred due to large claim settlement during the COVID-infected year, which signified the end of another decade.

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