INLAND REVENUE
AUTHORITY
OF SINGAPORE

IRAS e-Tax Guide

Tax Deductibility of General Insurers' Reserves Against Incurred But Not Reported Claims (IBNR Claims)

(Fourth Edition)

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1 Aim

1.1 The purpose of this e-Tax Guide is to set out the guidelines in determining acceptable methodologies for estimating the liability which can be used to quantify the reserves for IBNR claims to be allowed a deduction for tax purposes. It also sets out the substitute methods which may be used to derive an indication of what could be a reasonable level of reserves for IBNR claims which is acceptable for tax deduction purposes.

1.2 This e-Tax Guide is applicable to insurers carrying on a general insurance business where their policy liabilities[1] are not required to be certified by an actuary under section 35(1) of the Insurance Act 1966 and prior to their implementation of Financial Reporting Standard ("FRS") 117. For general insurance companies that have implemented the FRS 117 tax treatment (effective from YA 2024 for insurers whose financial year end is 31 December and from YA 2025 for insurers with non-December financial year end), please refer to the e-Tax Guide "Income Tax: Taxation of Insurers Arising from Adoption of FRS 117 – Insurance Contracts" instead.

2 At a glance

2.1 The loss triangulation method, which elicits loss development patterns based on historical data collated in the form of basic loss development triangles, is a method widely used internationally to arrive at the provision for IBNR claims. IRAS has agreed to accept this method.

2.2 For general insurance companies that are unable to collate historical data to enable them to use the loss triangulation method, IRAS is prepared to consider alternative methods. These alternative methods are described in detail in paragraph 4.3 below for the various types of insurers.

[1] Regulation 19 of the Insurance (Valuation and Capital) Regulations 2004 states that policy liabilities of a general business are made up of premium and claim liabilities, and claim liabilities include IBNR claims as per Regulation 19(1)(b).

3 Background

3.1 Under Singapore tax law, expenses are deductible for tax purposes if they are wholly and exclusively incurred in the production of income. Reserves provided for IBNR claims by general insurance companies were considered not deductible as they are not expenses which have been incurred in the production of income at the time the reserves created are claimed as a deduction. The amount of such reserves do not reflect the actual expenses or liabilities but are only estimates of contingent liabilities.

3.2 General insurance companies which made claims for the deduction of such reserves objected to the disallowance of the claims. IRAS noted that the Courts in Australia and the UK had ruled that such reserves were deductible if they were made on a reliable basis. Representations were also made by MAS to the effect that the Insurance Act 1966 required the provisions of adequate reserves for IBNR claims in order to promote sound insurance practice. MAS felt that such reserves should therefore be allowed a tax deduction. On account of these factors, IRAS agreed in 1992 to treat provisions for IBNR claims as qualifying for deduction. Since the issue concerned allowing a deduction of an amount of liability which is expected to have been incurred, an important related issue was in finding the methodology which could estimate the expected liability with a high degree of reliability, which this e-Tax Guide addresses.

4 Current Tax Treatment

4.1 The conceptual basis for allowing deduction of a provision for IBNR claims is that the actual claims subsequently received are capable of accurate estimation beforehand. Consequently, only provisions for IBNR claims which are made with methods using historical statistical evidence to arrive at the amount of such provisions are considered as acceptable. In other words, for provisions of IBNR claims to be acceptable, they must be supported by reliable statistical evidence. IRAS has been informed by MAS that a method widely used internationally to arrive at the provision for IBNR claims is the loss triangulation method which elicits loss development patterns based on historical data collated in the form of basic loss development triangles. As this basis of arriving at the provisions for IBNR claims is based on historical data, IRAS agreed to accept it.

4.2 Having done so, IRAS received further representations that there are general insurance companies which are unable to collate historical data to enable them to use the loss triangulation method because of the following reasons:

(a) unstable claims statistics;

(b) lack of historical data where the lines of business are new to the Singapore market;

(c) foreign insurers who lack Singapore claim statistics to provide for loss triangulation.

4.3 In view of the above reasons, IRAS is prepared to consider the following alternative methods:

(a) Direct Insurers

i. For their Singapore Insurance Fund business, the table of percentages of net written premiums at Annex 1 (indicative of the industry norm) will be accepted as a guide to determine the maximum annual allowable provision for IBNR claims. An external auditors' certification of claim liabilities valued in accordance with Regulation 19 of the Insurance (Valuation and Capital) Regulations 2004 has to be furnished.

ii. For their Offshore Insurance Fund business, the use of the percentage-based IBNR estimates to compute the provision will be accepted on the strength of the external auditor's certification of claim liabilities valued in accordance with Regulation 19 of the Insurance (Valuation and Capital) Regulations 2004.

(b) Reinsurers

The use of the percentage-based IBNR estimates to compute the provision will be accepted on the strength of the external auditors' certification of claim liabilities valued in accordance with Regulation 19 of the Insurance (Valuation and Capital) Regulations 2004.

(c) Captive Insurers

The use of the table of percentages at Annex 2 to compute the provision will be accepted as these percentages have been derived from industry experience worldwide. An external auditors' confirmation of claim liabilities valued in accordance with Regulation 19 of the Insurance (Valuation and Capital) Regulations 2004 has to be furnished.

(d) Foreign Insurers

Foreign insurers who lack claims statistics of their Singapore business to use the loss triangulation or other methods described above, may on providing proper justification, use Head Office statistics or methodologies.

(e) Other methods

Any other statistical methods used by insurance companies will only be accepted if IRAS is satisfied that these methods are based on historical statistical evidence and the companies furnish an external auditors' certification of claim liabilities valued in accordance with

Regulation 19 of the Insurance (Valuation and Capital) Regulations 2004.

4.4 Where IRAS has doubts regarding the appropriateness of the use of any of such alternative methods by an insurance company, it is the responsibility of the insurance company to demonstrate that the method used and the consequent amount of provision claimed have a valid basis in relation to the circumstances of its business. Once accepted, the method and its component parameters must be consistently applied. IRAS must be notified immediately of any change to the method and its component parameters.

4.5 Where business judgement has been used to modify the data used in the statistical methods or their outcome so as to ensure the accuracy of the IBNR estimates, IRAS is prepared to accept the modification based on such business judgement. However, where the use of business judgement leads to an increase of the IBNR estimates generated from statistical methods, the acceptance of the outcome can only be considered on a case-by-case basis. It would be for the insurance company concerned to substantiate that the increase is for valid reasons, for example, new legislation or court rulings governing liability payouts. Any increase of the IBNR estimates without valid reasons, for example, mere estimation, would not qualify for deduction.

4.6 The same applies where specific case reserves are also set aside as a result of incurred catastrophe events. The deduction for such reserves will only be considered on a case-by-case basis.

4.7 The methods described in paragraphs 4.1 and 4.3 are to be used with effect from the year of assessment 1996.

4.8 As business practice can change over time, IRAS may review this e-Tax Guide if necessary.

5 Contact Information

If you have any enquiries or need clarification on this e-Tax Guide, please call 1800 356 8622.

6 Updates and Amendments

	Date of amendment	Amendments made
1	13 Dec 2007	• Inserted a new paragraph 1.2. • Replaced "Fifth Schedule to the Insurance (Accounts and Statements) Regulations" with "Regulation 19 of the Insurance (Valuation and Capital) Regulations 2004 (amended in 2005)" in paragraph 4.3 (c)
2	14 Feb 2019	• Inserted footnote 3 in Annex 1
3	8 Jul 2024	• Updated the e-Tax Guide based on the current e-Tax Guide format. • Updated paragraph 1.2 to state who this e-Tax Guide applies to. • Amended paragraphs 4.3(a)(i), 4.3(a)(ii), 4.3(b) and 4.3(e) to replace the term "loss reserves" with "claim liabilities" and replaced "Fifth Schedule to the Insurance (Accounts and Statements) Regulations", which has since been revoked, with "Regulation 19 of the Insurance (Valuation and Capital) Regulations 2004". • Replaced the term "loss reserves" with "claim liabilities" and removed the reference to "(amended in 2005)" in paragraph 4.3(c). • Amended footnote 2 of Annex 1 to update the reference made from "section 37(1)(b)" to "section 95(1)(b)" as the provision has been renumbered in the 2020 Revised Edition of the Insurance Act 1966.

Annex 1 – General Direct Insurance IBNR[2] Percentage Table (SIF)

Class of Business	Maximum IBNR Factor as % of Net Written Premium [1/]
Fire	10
Miscellaneous	15
Motor	20
Workmen's Compensation	20
Marine and Aviation Cargo	20
Marine and Aviation Hull	25

[1/] Net Written Premium = Gross Premium - Reinsurance Premiums Ceded

Note:

The table essentially expresses maximum tax-allowable IBNR for any YA as a percentage of net premiums written by class of business in that YA. The table assumes a maximum claims development period of a year. In other words, any IBNR provision amount which is unutilised within a year should be released back into profits, and fresh IBNR set up in respect of the new YA in accordance with the table.

[2] This is applicable to a non-captive general insurance business where its policy liabilities are not required to be assessed and certified by an actuary approved by MAS under section 95(1)(b) of the Insurance Act 1966.

Annex 2 – Captive Insurance IBNR Percentage Table

Class of Business	DEVELOPMENT YEAR						
		1	2	3	4	5	6
Short	Outstanding Loss Reserves [2/] OR	20%	15%	10%	5%	0%	0%
Tailed [1/]	Incurred loss [3/] OR net written premium [4/]	10%	7.5%	5%	2.5%	0%	0%
Medium	Outstanding Loss Reserves [2/] OR	40%	30%	20%	10%	5%	5%
Tailed [1/]	Incurred loss [3/] OR net written premium [4/]	20%	15%	10%	5%	2.5%	2.5%
Long	Outstanding Loss Reserves [2/] OR	60%	50%	40%	30%	20%	10%
Tailed [1/]	Incurred loss [3/] OR net written premium [4/]	30%	25%	20%	15%	10%	5%

1/ Definitions of short to long-tailed business as well as indicative classes of business falling within these definitions are at Annex 2A and 2B.

2/ Outstanding Loss Reserves = Case Reserves (or Reserves for Reported Losses)

3/ Incurred Loss = Outstanding Loss Reserves + Paid and Outstanding Claims

4/ Net Written Premium = Gross Premiums - Reinsurance Premiums Ceded

<u>Note:</u>

The table contains 3 possible reserving bases (outstanding loss reserves, incurred loss or net written premiums). While a captive may, where appropriate, use more than one reserving base if it writes more than one class of business, the base chosen in respect of any individual class of business has to be used consistently from year to year and any change has to be justified. Based on the table, IBNR established in respect of business written in anyone Year of Assessment are held over a specified maximum number of development years on a reducing basis until extinction. The reductions over the years offer an approximate idea of claims development. Reserves not actually utilised to meet claims in a particular development year must be written back to profits.

Annex 2A – Definition

Short Tailed Risks

Occurrences of such claims are normally known within 12 months from inception of the policy. Estimate of ultimate loss value could however be finalised some time after the event of the loss. The loss would generally be determined within 48 months from inception of the policy.

Medium Tailed Risks

Occurrences of such claims may not normally be known within 12 months from inception of the policy. Where incidents are reported, circumstances and liability may not be determined with certainty during the early stages of loss development (eg first 36 months).

Long Tailed Risks

Occurrences of such claims are often unknown and unquantifiable within 12 months from the inception of the policy. Policy obligations are often very difficult to quantify leading to large variances in provision in the earlier years of loss development. Quantum of losses may be affected by retrospective changes in legislation and emerging judicial trends for higher damage awards. The significant loss developments of these classes of business are often well documented.

Annex 2B – Classes of Insurance

MAJOR CLASSES	SUB-CLASSES		SHORT TAIL	MEDIUM TAIL	LONG TAIL
FIRE	(F1)	Fire, Explosion & Lightning	Yes		
	(F2)	Fire & Extraneous Perils	Yes		
	(F3)	Industrial Special Risks	Yes		
		Including Marine Inland		Yes	
		Including Marine Overseas			Yes
		Including Fidelity Guarantee			Yes
	(F4)	Business Interruption		Yes	
	(F5)	Advanced Profits		Yes	
	(F6)	Homeowners	Yes		
		Including Liability		Yes	
	(F7)	Householders	Yes		
		Including Liability		Yes	
	(F8)	Contractor's Risks	Yes		
		Including Liability		Yes	
		Including Marine Inland		Yes	
		Including Marine Overseas			Yes
	(F9)	Mortgagee's Interest	Yes		
	(F10)	Terrorism	Yes		
CASUALTY	(C1)	Hull	Yes		
	(C2)	Motor Vehicle	Yes		
		Including Third Party Property Damage		Yes	
	(C3)	Theft	Yes		
	(C4)	Fidelity Guarantee			Yes
	(C5)	Personal Accident	Yes		
	(C6)	Travel		Yes	
	(C7)	Livestock	Yes		
	(C8)	Bloodstock	Yes		
	(C9)	Libel/Slander		Yes	
	(C10)	Keyman	Yes		
	(C11)	Money	Yes		
ENGINEERING	(E1)	Erection Risks	Yes		
		Including Liability Including		Yes	
		Marine Inland Including		Yes	
		Marine Overseas Including			Yes
		Advance Profits		Yes	
	(E2)	Mechanical/Electrical Breakdown	Yes		
	(E3)	Boiler Explosion/Collapse	Yes		
		Including Liability		Yes	

MAJOR CLASSES	SUB-CLASSES		SHORT TAIL	MEDIUM TAIL	LONG TAIL
MARINE	(M1)	Stockthroughput		Yes	
	(M2)	Cargo Inland		Yes	
	(M3)	Cargo Overseas			Yes
	(M4)	Hull			Yes
	(M5)	Protection & Indemnity			Yes
	(M6)	Builder's Risks	Yes		
	(M7)	Yacht and Pleasure Craft		Yes	
	(M8)	Marine Liability			Yes
	(M9)	War		Yes	
LIABILITY	(L1)	Public			Yes
	(L2)	Product			Yes
	(L3)	Directors' & Officers'			Yes
	(L4)	Trustee's			Yes
	(L5)	Lender's			Yes
	(L6)	Professional Indemnity			Yes
	(L7)	Errors & Omissions			Yes
	(L8)	Umbrella			Yes
	(L9)	Excess			Yes
	(L10)	Personal			Yes
	(L11)	Carrier's and Warehouseman's			Yes
	(L12)	Miscellaneous			Yes
OTHERS	(O1)	Malicious Product Tamper			Yes
	(O2)	Product Recall/Guarantee		Yes	
	(O3)	Political Risks (Confiscation, Expropriation & Nationalisation)		Yes	
	(O4)	Trade Credit		Yes	
	(O5)	Strikes		Yes	
	(O6)	Salary Continuance		Yes	
	(O7)	Health Care		Yes	
	(O8)	Residential Mortgage			Yes
	(O9)	Commercial Mortgage			Yes
	(O10)	Kidnap & Ransom	Yes		
	(O11)	Aviation Hull			Yes
	(O12)	Aviation Liability			Yes
	(O13)	War			Yes
	(O14)	Space	Yes		
	(O15)	Space Liability			Yes
	(O16)	Worker's Compensation			Yes
	(O17)	Employer's Liability			Yes
	(O18)	Bankers' Blanket Bond and Electronic Computer Crime			Yes
	(O19)	Environmental Impairment			Yes
	(O20)	Stop Loss			Yes
	(O21)	Mine Rehabilitation			Yes