LC Paper No. CB(1)458/18-19(01)

Inland Revenue and MPF Schemes Legislation (Tax Deductions for Annuity Premiums and MPF Voluntary Contributions) (Amendment) Bill 2018

1st Meeting of Bills Committee

Financial Services and the Treasury Bureau
11 January 2019

Background

- 2018-2019 Budget initiative – tax deductions to encourage voluntary savings for retirement
- 2017: out of the $68.99 billion total MPF contributions received, $3.46 billion was voluntary contributions (5%)
- Annuity premiums are growing:

	2012	2017
No. of in-force annuity policies	63,420	151,673 (+139%)
Premiums	$ 2.9 billion	$12.2 billion (+313%)

Basic concepts of annuity

- A long term insurance contract
- Objective: paying premiums for a stable income stream
- Each payout includes principal and interest (investment income)

- Difference between immediate annuity and deferred annuity
  - Immediate annuity does not have an accumulation period. Policy holders pay a lump sum premium for receiving monthly annuity income right away
  - Deferred annuity has an accumulation period. Policy holders can pay premiums by instalments to accumulate a sum for investment income, and receive annuity income after a certain period of time

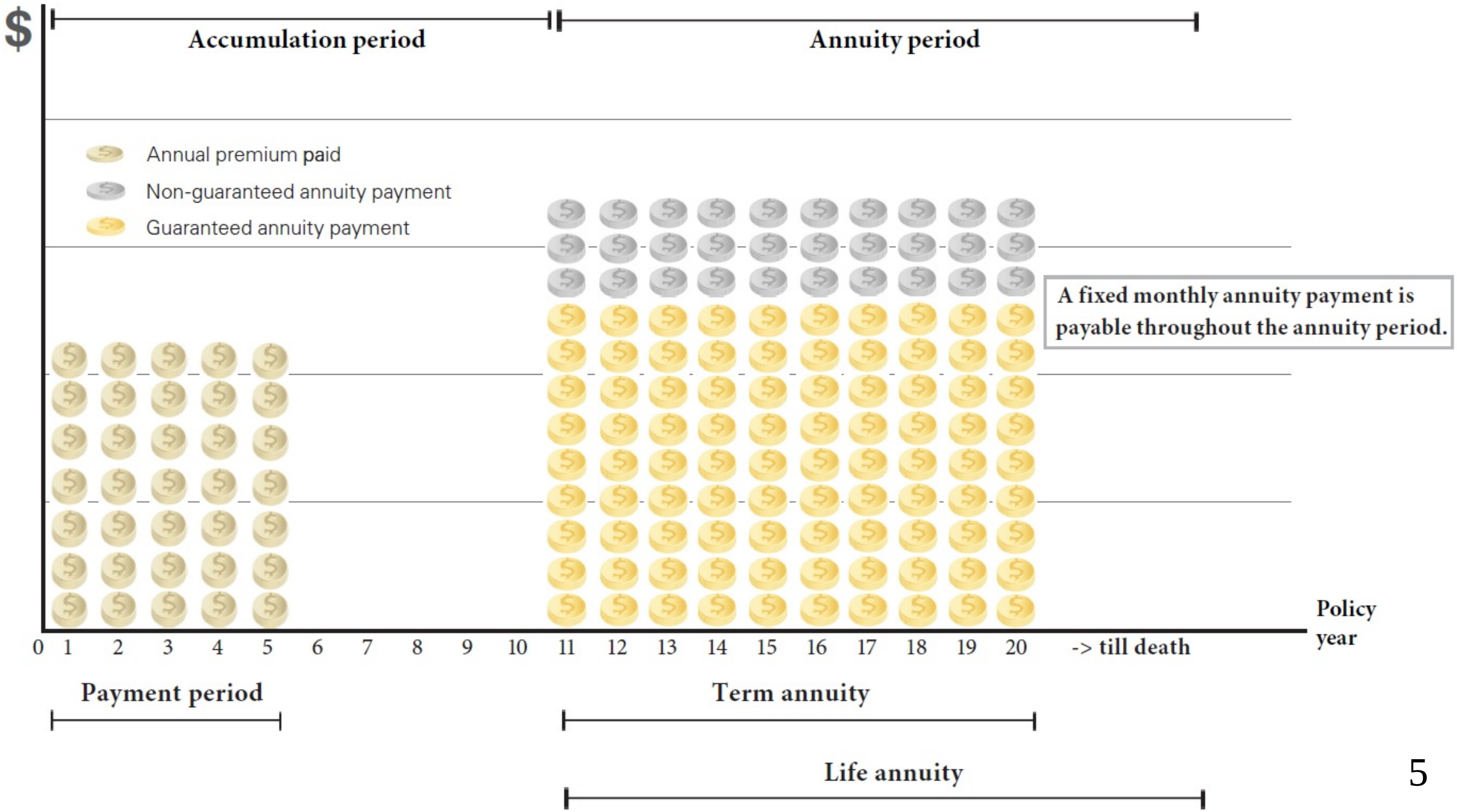
- Difference between life annuity and term annuity
  - Life annuity refers to a policy where the insurer must pay annuity until the death of the annuitant
  - Deferred annuity refers to a policy with a specific annuity period, such as 15 years, 20 years, or up to the age of 100

Basic concepts of annuity (cont'd)

- Some annuities are designed to pay a fixed guaranteed amount each time during the payment period, while the payment of some includes a guaranteed portion and a non-guaranteed portion

- The Government's proposal is that deferred annuity meeting relevant requirements can be life annuity or term annuity. The payouts must clearly specify the guaranteed and non-guaranteed portions

Graphic illustration of a deferred annuity



Annuities

- Annuity is not suitable for everyone. The following factors should be considered :

  - liquidity needs
  - bequest motive
  - financial discipline
  - other alternatives

Criteria for eligible deferred annuities

- **Minimum total premium of $180,000 and minimum payment period of 5 years**

  - To encourage people to save a small sum regularly for a stable stream of post-retirement income
  - There is a lack of sufficient public understanding of annuity. Many may not be amenable to being bound by a contract to accumulate a relatively large sum of money. To benefit more taxpayers, the eligible minimum total premium should not be set too high
  - If the minimum total premium is set too low, the accumulated sum will not be sufficient to generate meaningful income for retirement financial planning

Criteria for eligible deferred annuities (cont'd)

- **Minimum annuity period of 10 years**
  - We consider that too short an annuity period may not be meaningful for retirement planning. We recommend a minimum annuity period of 10 years after consulting the industry

- **Annuitisation only at the age of 50 or beyond**
  - After consulting the industry, we consider that 50 is a reasonable minimum annuitisation age for retirement purpose

Criteria for eligible deferred annuities (cont’d)

<u>Measures protecting consumers’ interests</u>

- Disclosure requirements

  - <u>Internal Rate of Return (IRR)</u> - must be clearly stated in the sales brochure and relevant communications with the holder of an eligible annuity. The IRR is a useful standard yardstick for clients to evaluate and compare eligible products before making an informed purchase decision
  - Clear presentation of the <u>guaranteed payment amount (minimum at 70% in general)</u> and <u>non-guaranteed payment amount</u>
  - <u>Clear separation</u> of premiums of all <u>riders</u> (e.g. critical illness, hospitalisation cash, etc.) from eligible annuity premiums

MPF Tax Deductible Voluntary Contributions

Existing arrangements

Deducted from salary

Mandatory Contribution

Existing tax deduction limit of $18,000

Voluntary Contribution

No tax deduction currently

Tax Deductible Voluntary Contribution

Tax deduction limit of $60,000

If there is no separate **TVC** account, it will involve a lot of administrative work to allow scheme members to choose whether they would like to subject their VC to the preservation requirement for enjoying the tax deduction. Apportioning **tax deductible and non-tax deductible contributions** within one account will also create tedious administrative work.

Tax deductions

- Maximum tax deductible limit per year is $60,000 per taxpayer. It is an aggregate limit for MPF TVC and deferred annuity premiums

- Flexible arrangement. A taxpayer may claim the maximum $60,000 deductible limit , irrespective of whether the taxpayer –
    a) only makes $60,000 of TVC; or
    b) only pays $60,000 of qualifying deferred annuity premiums; or
    c) making contributions to TVC and paying qualifying deferred annuity premiums at the same time in different respective amounts

Tax deduction arrangements for spouses

- A taxpayer is allowed to claim tax deductions for deferred annuity premiums covering the couple as a joint annuitant, or either the taxpayer or the taxpayer's spouse as a sole annuitant

Assuming that the husband (but not the wife) is a taxpayer

Example 1

Policy holder
Husband

Annuitant
Husband

Example 2

Policy holder
Husband

Annuitant
Wife

Example 3

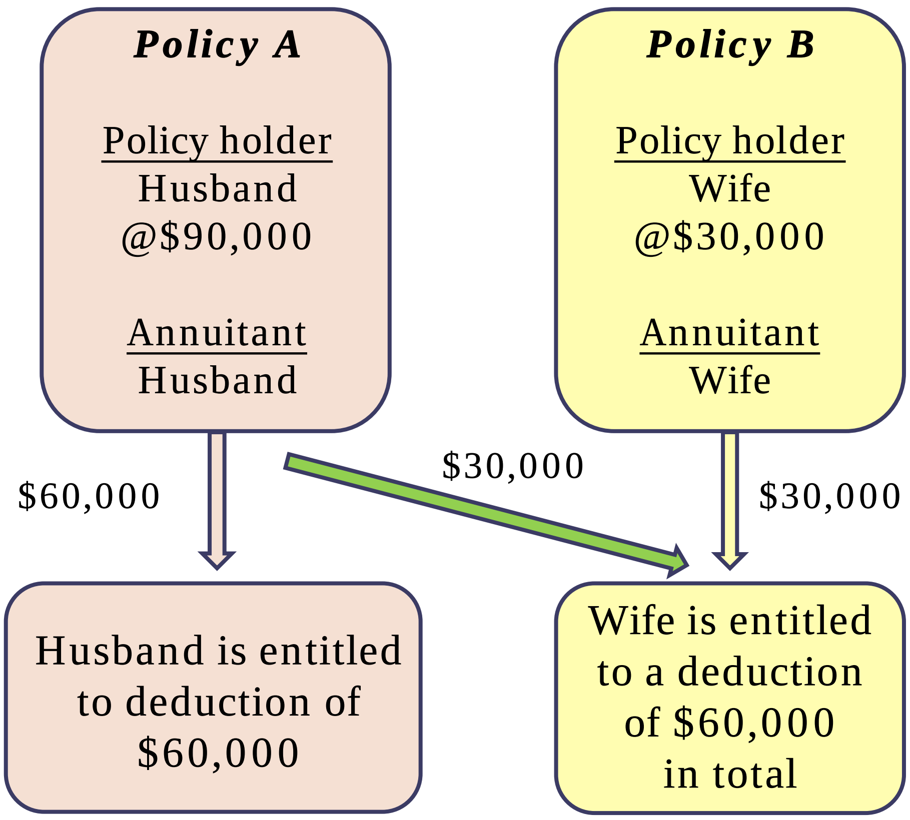
Policy holder
Husband

Annuitant
Husband + Wife

In all the above three examples, the husband (i.e. the taxpayer) can claim tax deductions for the relevant deferred annuity premiums

Tax deduction arrangements for spouses (cont'd)

- A taxpaying couple may flexibly allocate tax deduction for qualifying deferred annuity premiums amongst themselves in order to enjoy a maximum tax deductible limit of a total of $120,000 , so long as the deductions claimed for each of them do not exceed $60,000



Illustrations of tax savings

	A Single, monthly salary $15,000	B Single, monthly salary $20,000	C Single, monthly salary $30,000	D Single, monthly salary $60,000	E Married, 1 child, monthly salary $60,000 Spouse not working
Income ($)	180,000	240,000	360,000	720,000	720,000
Less: deduction ($) (MPF mandatory contributions)	9,000	12,000	18,000	18,000	18,000
Less: allowances ($)	132,000	132,000	132,000	132,000	264,000 120,000
Net chargeable income ($)	39,000	96,000	210,000	570,000	318,000
Tax payable ($) (a)	780	3,760	17,700	78,900	36,060

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Income ($)	180,000	240,000	360,000	720,000	720,000
Less: deduction($) (MPF mandatory contribution)	9,000	12,000	18,000	18,000	18,000
Less: deduction ($) (MPF TVCs or deferred annuity premiums)	9,000*	12,000*	18,000*	60,000	60,000
Less: allowances ($)	132,000	132,000	132,000	132,000	264,000 + 120,000
Net chargeable income ($)	30,000	84,000	192,000	510,000	258,000
Tax payable ($)(b)	600	3,040	14,880	68,700	25,860
Tax savings ($) (a) – (b)	**180**	**720**	**2,820**	**10,200**	**10,200**

* For scenarios A, B and C, it is assumed that given his/ her relatively low income, the taxpayer will not make claims with the full tax deductible amount for MPF TVCs or deferred annuity premiums

Public education and point-of-sale conduct

- IA to publish a list of eligible deferred annuity products on its website
- IA and MPFA to collaborate with the Investor Education Centre and the industry on public education campaigns
- IA and MPFA to continue to closely monitor the point-of-sale conduct of intermediaries, including mystery shopper programme

Implementation timetable

Time frame	Remarks
By end-Mar 2019	Passage of the bill / publication of the list of eligible products on IA's website
From early 2019	Publicity and education programmes by IA, MPFA, Investor Education Centre and the industry
From assessment year 2019/20	Tax deduction to take effect

Q&A