

# New guidance on classification of insurance-based investment products

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## Introduction

### Case law

### Council decision

### Comment

## Introduction

The Council for Advance Tax Rulings – a government agency which may, on a taxpayer's request, provide binding advance rulings on matters of taxation – has further clarified the demarcation between insurance products and other investment products under Swedish law.

The council found that a unit-linked insurance plan under which a beneficiary was entitled to 99% of the invested capital upon realisation of the insured risk and the policyholder received no risk compensation during the insurance period did not constitute an insurance product under Swedish law.

The principal matter addressed by the council (100-17/D of 20 February 2019) was whether the product in question qualified as Swedish 'capital insurance' – a life insurance product that mainly functions as an investment product offered by insurers, rather than a traditional insurance contract. Under a capital insurance policy, the policyholder may instruct the insurer to invest the policyholder's capital in financial instruments. Should the policyholder die during the policy period, the beneficiary will be entitled to the capital held under the policy plus or minus a certain percentage.

Importantly, in such contracts:

- the insurer, not the policyholder, owns the assets;
- capital insurance is subject to an annual yield tax based on the value of the policy (currently, the effective tax is approximately 0.45% of the value); and
- the policyholder pays no tax on any capital gains on the assets held.

## Case law

The Supreme Administrative Court has previously found that a unit-linked insurance plan under which a policyholder was entitled to 101% of the invested capital upon realisation of the insured risk (ie, the policyholder's death) qualified as an insurance product under Swedish law (RÅ 1994 notes 19 and 20). The court has also found that a unit-linked insurance policy under which a policyholder was entitled to only 99% of the invested capital but instead continuously received risk compensation constituted an insurance product (HFD 2015 note 54).

However, a unit-linked insurance plan under which the risk element is 0.1% and yearly fees are 1.2% of the invested capital does not qualify as an insurance product, since these terms in effect render such an agreement irrelevant from an insurance perspective (RÅ 2008 ref 54).

## Council decision

The question before the Council for Advance Tax Rulings on 20 February 2019 (100-17/D) was whether a unit-linked insurance plan under which the policyholder was entitled to 99% of the invested capital upon realisation of the insured risk and the policyholder received no risk compensation during the insurance period qualified as an insurance product under Swedish law.

As in several of the abovementioned Supreme Administrative Court cases, the Swedish Financial Supervisory Authority (SFSA) was consulted as to whether the product qualified as an insurance product under Swedish insurance law.

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The SFSA stated that life insurance is a means of spreading risk within a collective of insureds (ie, those living longer and shorter lives). Therefore, some form of compensation for such risk is necessary for a product to constitute a life insurance product. According to the SFSA, if a policy grants a beneficiary 99% of the invested capital on the policyholder's death and there is no other form of risk compensation, there is no spread of risk between the insureds. The proceeds are then based solely on returns on the invested capital and the fees paid. Therefore, the product in question was not deemed relevant from an insurance perspective, but was instead found to constitute a pure investment product.

The Council for Advance Tax Rulings accepted the SFSA's statement and ruled that the product in question could not be considered an insurance product. The council explicitly stated that the classification of an insurance product in tax matters must be based on the classification under Swedish insurance law.

### **Comment**

The council's decision clarifies what is required for a unit-linked insurance policy to constitute an insurance product under Swedish law. The key criterion appears to be that an insured risk must be spread out over a collective of insureds. Based on current case law, it seems that this could be achieved by the beneficiary of each policyholder receiving 101% (in exchange for a risk premium) or 99% (in exchange for risk compensation) of the invested capital on the occurrence of the insured event.

Nevertheless, the decision leaves certain questions open, including how the risk compensation must be designed in order for the product to constitute an insurance product. For example, it seems reasonable that a policyholder with a 99% capital insurance policy would expect to pay reduced fees or premiums compared with a policyholder with a 101% capital insurance policy. However, the decision does not appear to take a clear stance as to whether an acceptable form of risk compensation may be reduced fees or premiums or whether the risk compensation must be expressly annotated as such.

Moreover, the decision does not discuss whether a certain minimum risk level is still required for a product to constitute an insurance product. Previous case law has indicated that a risk level of 0.1% on invested capital is too small to constitute an insurance product (RÅ 2008 ref 54). However, in that case the risk level of 0.1% was put in contrast to the yearly fees of 1.2% and thus it remains uncertain what an acceptable minimum risk level would be. This would likely require a case-by-case risk assessment in relation to a product's other conditions.

The exact location of the line between pure investment contracts and insurance-based investment products is important for insurers and policyholders in Sweden, both from a regulatory standpoint and from a tax perspective. The council's ruling, which has been appealed to the Supreme Administrative Court, will doubtless provide useful guidance and be carefully reviewed within the industry. However, since there are still many unanswered questions, further guidance will likely be required in the years to come in order to clear the murky waters in this regard.

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