EXPLANATORY MEMORANDUM TO

THE INSURANCE COMPANIES (TRANSITIONAL PROVISIONS) REGULATIONS 2012

2012 No. 3009

1. This explanatory memorandum has been prepared by HM Revenue and Customs (HMRC) on behalf of Her Majesty's Treasury and is laid before the House of Commons by Command of Her Majesty.

2. Purpose of the instrument

2.1 The Finance Act 2012 introduced a new corporate tax regime for life insurance companies and friendly societies to have effect from 1 January 2013. That legislation includes rules for the transition to the new regime. This instrument contains further detailed transitional rules to supplement those in the Act.

3. Matters of special interest to the Select Committee on Statutory Instruments

3.1 None.

4. Legislative Context

4.1 The taxation of life companies is currently based on regulatory returns made to the Financial Services Authority (FSA). The current legislation is largely contained within Chapter 1 of Part 12 of the Income and Corporation Taxes Act 1988 and Chapter 1 of Part 2 of the Finance Act 1989. The European Union Solvency II Directive will fundamentally change the regulatory framework which applies to life companies. As a result of these changes, regulatory returns made to the FSA will no longer provide the information necessary to make the current legislation work.

4.2 Part 2 of the Finance Act 2012 therefore contains a new regime for the taxation of life companies; and Part 3 modifies those rules to apply to friendly societies.

4.3 Schedule 17 to the Finance Act 2012 provides the basic rules setting the framework for the transition from the current to the new regime. This instrument provides further, more detailed transitional rules.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

- ***What is being done and why***

7.1 At Budget 2011 the Government announced the main features of a new corporate tax regime for life insurers, to apply from 1 January 2013.

7.2 Changes under the new regime are fundamental and extensive. The main change is that trading profits will be calculated on the basis of life companies' statutory accounts, in line with general tax rules. Currently, these profits are derived from information provided in regulatory returns made by life companies to the FSA. There are significant differences between the treatments required for regulatory and accounting purposes, particularly in the timing of the recognition of income and expenditure, and in the valuation of assets and liabilities.

7.3 Schedule 17 to the Finance Act 2012 sets out the framework of a mechanism which reconciles these differences on transition, and ensures that all tax- effective items are taxed or relieved appropriately. Differences are identified by a comparison of balances in regulatory returns and accounts, and tax-effective differences are generally spread forward and taxed or relieved over 10 years. In addition Schedule 17 sets out transitional arrangements for a number of specific tax rules.

7.4 These Regulations provide detailed rules about how the comparisons of balances are to be made; about which transitional differences are to be treated as tax-effective; and how those differences are to be allocated between the various classes of business carried on by life companies.

- **Consolidation**

7.5 There are no relevant instruments to consolidate.

8. Consultation outcome

8.1 HMRC has consulted extensively, formally and informally, to ensure that the new tax regime for life companies, including the transitional arrangements, will operate fairly and effectively. A formal consultation on the new regime, including some transitional aspects, took place between 5 April and 28 July 2011. A summary of responses was published on 6 December 2011, alongside draft primary legislation. That draft was developed into the legislation included in the Finance Act 2012.

8.2 Since April 2012, several drafts of this instrument have been shared with industry representatives and advisers; they have been discussed in detail at a series of meetings of a joint working group established by HMRC and the industry, and with individual stakeholders. In addition, draft regulations were published for comment, in accordance with HMRC's Tax Consultation Framework (http://www.hmrc.gov.uk/consultations/tax-consultation-framework.pdf), for a period of four weeks starting on 22 October 2012.

8.3 This process has enabled HMRC to develop these Regulations in partnership with interested stakeholders, from whom extensive assistance and input has been received. These contributions have resulted in Regulations which stakeholders, including the main industry representative bodies, support. They are generally regarded as focused, aligned to commercial realities, and an appropriate and effective basis for the calculation of transitional adjustments.

9. Guidance

9.1 Guidance on the new regime, including the application of these Regulations, will be made available on the HMRC website.

10. Impact

10.1 The Regulations affect the life insurance sector only (approximately 250 companies including friendly societies). There is no impact on charities, the voluntary sector or the public sector.

10.2 There will be some one-off familiarisation and training costs for tax specialists in affected businesses. The impact on compliance and ongoing annual administrative costs will be negligible.

10.3 A Tax Information and Impact Note covering this instrument was published on 6 December 2011 alongside draft clauses for the 2012 Finance Bill and is available on the HMRC website at http://www.hmrc.gov.uk/thelibrary/tiins.htm. It remains an accurate summary of the impacts that apply to this instrument.

11. Regulating small business

11.1 The legislation applies to small businesses.

11.2 The new rules may affect up to 30 friendly societies classified as small firms (that is, with fewer than 20 employees). These have to be included in the measure as they are part of the life insurance sector. However, the impact of the transitional rules on these firms is minimal since their business is mostly mutual, and trading profits are therefore largely not taxable.

11.3 The main representative body for friendly societies has been fully engaged in the consultation process.

12. Monitoring & review

12.1 HMRC has an established programme of liaison with the life insurance industry, which will capture issues around implementation and ongoing compliance. No special data should be needed for monitoring; tax returns will provide the information required to make an assessment of the tax impact of the new rules.

13. Contact

13.1 **Andy Stewardson** at the HM Revenue & Customs Tel: 0207 147 2600 or email: andy.stewardson@hmrc.gsi.gov.uk can answer any queries regarding the instrument.