EXPLANATORY MEMORANDUM TO

THE LIFE INSURANCE QUALIFYING POLICIES (STATEMENT AND REPORTING REQUIREMENTS) REGULATIONS 2013

2013 No. 1820

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

2. Purpose of the instrument

2.1 This instrument sets out the information that beneficiaries of qualifying policies need to provide to insurers and the information that insurers must report to HMRC in respect of certain issued qualifying policies.

2.2. The Finance Act 2013 introduced an annual premium limit of £3,600 on qualifying life insurance policies from 6 April 2013 and a requirement for beneficiaries of qualifying policies to make statements; for insurers to require information on the application for qualifying policies and for insurers to report information contained in the declarations to HMRC in respect of qualifying policies which enable HMRC to monitor that the limit is being complied with.

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

3.1 None.

4. Legislative Context

4.1 New paragraph B3 of Schedule 15 to the Income and Corporation Taxes Act 1988 ("the Taxes Act") requires beneficiaries of qualifying policies issued on or after 6 April 2013 to make a statement to the issuer of the policy on the occurrence of certain events.

4.2. Under new section 552ZB of the Taxes Act the Commissioners for HMRC may make regulations, which require beneficiaries of qualifying policies to provide information to insurers and for insurers to pass on the information received by them to HMRC.

4.3 This is the first exercise of these powers. The combination of the requirement to make a statement and the reporting requirement will allow HMRC to police the effective operation of the annual premium limit and will enable insurers to comply with existing reporting requirements in relation to chargeable events.

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 Prior to 1968, the only tax on life insurance policies was corporation tax paid by insurers on investment returns attributable to investors. At the time, there was increasing use of single premium investment policies to avoid high rates of income tax (surtax) applicable to returns from other investment vehicles.

7.2 To counter this avoidance, the Chargeable Event Gain regime was introduced in 1968. This regime applies income tax at the marginal rate to investment profits (gains) realised by policyholders although basic rate tax is treated as paid to reflect the corporation tax paid by UK insurers. The effect of the regime is that basic rate taxpayers with gains from policies issued by UK insurers have no further tax liability, and higher/additional rate taxpayers pay income tax on the difference between basic and higher rates.

7.3 As part of the 1968 changes certain gains from "qualifying policies" issued by UK insurers were excluded from the Chargeable Event Gain regime in order to preserve the tax treatment for what were seen as traditional life insurance policies, broadly long term, regular premium policies that include a significant element of protection insurance.

7.4 As individuals liable to income tax under the Chargeable Event Gain regime are in effect only liable at the difference between basic and higher rates of tax, the key beneficiaries of the QP regime are now taxpayers whose income is liable to tax at the higher rates, or individuals whose gains are sufficiently large so as to bring them within higher rates of tax.

7.5 There has never been a limit on the amount of premiums that can be paid into a qualifying policy, nor on the amount of gains that will be exempt from income tax. As a consequence of the introduction of the additional rate of income tax and the restriction to pension relief, there was evidence that a number of high net worth individuals were turning to qualifying life insurance policies as an alternative tax efficient investment vehicle.

7.6 In 2010, 420,000 qualifying policies (with aggregate premiums of £183 million per annum) were sold by about 12 friendly societies, 5 mutual insurers and 25 insurers. As at February 2012 there were approximately 20 million qualifying policies in force, although this number is falling as ISAs have become the more popular savings vehicle for more modest investors. Although relatively large numbers of qualifying policies are sold compared to non-qualifying policy investment products, the value of this business forms a very small part of aggregate UK life insurance ‘investment’ business (i.e. excluding pension or protection business). For example, in 2010 qualifying policies accounted for 58% of business policy number, but 1.5% by premium value (this figure is 16% and 11% of aggregate premium value for friendly society and mutual business, respectively).

7.7 The Government wishes to limit the relief available for qualifying life insurance policies. This measure supports the Government's objective of promoting fairness in the tax system by ensuring that tax relief for qualifying policies is correctly targeted.

7.8 Finance Act 2013 introduces a new condition to be met for qualifying policy status. The new condition is that the beneficiary of the policy must not have exceeded a new annual premium limit of £3,600 which applies from 6 April 2013.

7.9 This instrument assists the effective application of the new annual premium limit by requiring a statement from policy beneficiaries confirming that they have not breached the annual premium limit. It also provides for insurance companies to make annual reports to HMRC in relation to qualifying policies issued by them on or after 6 April 2013. The combination of these provisions will allow HMRC to ensure the effective application of the new annual premium limit.

7.10 This instrument amends the Life Assurance and Other Policies (Keeping of Information and Duties of Insurers) Regulations 1997 (S.I. 1997/265) to enable HMRC to monitor compliance with the requirements of this instrument.

8. Consultation outcome

8.1 A consultation document on the implementation of an annual premium limit of £3,600 in respect of qualifying life insurance policies was published on 15 June 2012. The consultation closed on 6 September 2012.

8.2 Officials followed up the consultation document with a series of meetings with an industry working group and with other stakeholders.

8.3 Draft primary legislation was published on 11 December 2012 and a draft of this instrument was published on 31 January 2013.

8.4 The drafting of this instrument reflects the comments made by respondents to those consultations. The main concern of stakeholders related to the extent of reporting that would be required by the industry. Following discussions, this has resulted in the reporting requirements being scaled down to curtail excessive burdens on industry whilst ensuring sufficient information is made available to HMRC to allow effective policing of the new annual premium limit.

9. Guidance

9.1 Guidance was published on HMRC's website on 8 April 2013 and further guidance on the same website accompanies this instrument. Further guidance will be published in the Insurance Policyholder Taxation Manual.

10. Impact

10.1 The regulations apply to taxpayers with qualifying life insurance policies and businesses that sell qualifying life insurance policies. There is no impact on charities or voluntary bodies.

10.2 A Tax Information and Impact Note covering this instrument was published on 11 December 2012 alongside draft legislation for qualifying insurance policies. A further updated Tax Information and Impact Note was published on 20 March 2013 as part of the 2013 Budget.

11. Regulating small business

11.1 The legislation applies to small businesses.

11.2 The consultation exercise revealed that the scale of reporting requirements originally contemplated would be burdensome for all businesses but would be particularly onerous for small businesses. Consequently, the scale of the reporting requirement has been limited considerably to reduce the burden on business as a whole but small businesses in particular whilst still providing sufficient information for HMRC to effectively police the application of the new annual premium limit. Specific types of life insurance policies (such as pure protection policies) have been excluded from the scope of the annual premium limit. In addition, there will be no reporting requirements for any life insurance policies issued before 6 April 2013.

12. Monitoring & review

12.1 The impact of the instrument will be kept under review to ensure that the policy objectives set out in paragraph 7 are met.

12.2 Regular communication with the industry will capture issues around implementation and ongoing compliance and administrative costs. In addition, individuals are required to prepare tax returns which will provide data to inform any such evaluation.

13. Contact

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