EXPLANATORY MEMORANDUM TO

THE INSURANCE COMPANIES AND CFCS (AVOIDANCE OF DOUBLE CHARGE) REGULATIONS 2012

2012 No. 3044

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 To mitigate administrative compliance burdens for life insurance companies in relation to the new corporate tax regime relating to controlled foreign companies ("CFCs") introduced by the Finance Act 2012 ("CFC rules").

2.2 The rules prevent double taxation of life insurance companies under the CFC rules and section 212 of the Taxation of Chargeable Gains Act 1992 (section 212) in relation to investments in CFCs

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

3.1 None

4. Legislative Context

4.1 Schedule 20 to the Finance Act 2012 (Schedule 20) introduced the rules (incorporated as Part 9A TIOPA 2010) setting the framework for the new tax regime for UK controlled foreign companies. The new CFC rules target only those profits that are considered to be artificially diverted from the UK.

4.2 Section 212 charges to tax the increase in value of investments in certain offshore funds held by life insurance companies by treating it as a chargeable gain. Such offshore funds can be CFCs and so also come within the CFC rules.

4.3 This instrument provides detailed rules on the interaction between section 212 and Part 9A TIOPA 2010.

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 The Finance Act 2012 introduced new CFC rules which have effect for CFCs with accounting periods beginning on or after 1 January 2013 and apply to overseas companies that are controlled by a UK person. The new CFC rules better reflect the way that businesses operate in a global economy whilst maintaining adequate protection against artificial diversion of UK profits.

7.2 The new CFC rules have given rise to two concerns: compliance burden and the potential for double taxation.

7.3 Compliance burden

The new CFC rules require companies to look at each offshore fund individually each year and consider whether any chargeable profits fall to be charged to tax in the UK under the CFC rules. Life insurance companies often have hundreds of offshore funds which would have to be reviewed. Such funds are held to generate investment returns for policyholders and in such cases there is minimal risk for potential loss of tax. In these situations, the additional costs of compliance that may arise are not commensurate with the potential loss of tax.

In order to minimise the above compliance burden these Regulations modify the application of the new CFC rules to ensure they generally will not apply unless the offshore fund would be consolidated into the life insurance company's statutory accounts due to the level of interest held. Where such consolidated funds (which would otherwise be a CFC) are equity holding funds the CFC rules will not apply provided there is no tax avoidance motive.

7.4 Double taxation

It is possible for the same profits to be taken into account under both the CFC rules and Section 212 which could lead to double taxation. It is not the policy of the Government that profits or gains should be taxed more than once. This instrument provides that this will not happen.

- **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 both the new tax regimes will operate fairly and effectively. The interaction of section 212 and Part 9A TIOPA 2010 has been part of that consultation exercise.

8.2 In October 2012 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. All commentators were content with the drafting.

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 better focused and aligned to commercial realities.

9. Guidance

9.1 Guidance on the new regime, including the application of this instrument, 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 or 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 Assessment (TIIN) has not been prepared for this instrument. The impact of the regulations is covered by the main TIIN for CFC reform, issued on 21 March 2012 as part of the 2012 Budget process and is available on the HMRC website at http://www.hmrc.gov.uk/thelibrary/tiins.htm.

11. Regulating small business

11.1 The legislation applies to small businesses.

11.2 The new rules may affect approximately 30 Friendly Societies classified as small firms (that is, with fewer than 20 employees). However, these rules are unlikely to have any impact on such firms due to regulatory rules on holding subsidiaries.

11.3 In cases where these Regulations apply the impact on compliance burdens is relieving.

11.4 The main representative body for Friendly Societies has been fully engaged in consultation. To enable the provisions to be accessed by all potential users HMRC will provide guidance in consultation with industry representatives.

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 **Tina Jacob** at the HM Revenue & Customs (Tel: 0207 147 0517 or email: christina.jacob@hmrc.gsi.gov.uk) can answer any queries regarding the instrument.