EXPLANATORY MEMORANDUM TO

THE INSURANCE COMPANIES (MODIFICATION OF THE CORPORATION TAX ACTS) (AMENDMENT No. 2) ORDER 2006

2006 No. 3387

1. This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs and is laid before the House of Commons by Command of Her Majesty.

2. Description

The Order modifies the Corporation Tax Acts as they apply to insurance companies so that the effects of changes made in an instrument made by the Financial Services Authority ("FSA") to the calculation of a company's liabilities to its policy holders does not have a deleterious tax impact on those companies.

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

None

4. Legislative Background

The Order is made under section 431A(1) and (2) of the Income and Corporation Taxes Act 1988 ("ICTA"). That power is designed to allow for the tax consequences of changes made by the FSA to the regulatory rules for insurance companies. The tax treatment of such companies is heavily dependent on entries made in the periodical return made by them to the FSA which is required by those FSA Rules.

5. Extent

The instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Economic Secretary to the Treasury (Ed Balls MP) has made the following statement regarding Human Rights:

> In my view the provisions of the Insurance Companies (Modification of the Corporation Tax Acts) (Amendment No. 2) Order 2006 are compatible with the convention rights

7. Policy Background

7.1 An insurance company carrying on long-term business must make a number of calculations of the profit it derives from different types of long-term business. In making that calculation it will take into account the difference between its opening and closing liabilities to policy holders. For categories of life assurance business, "liabilities" is defined in section 431(2) of the Income and Corporation Taxes Act 1988 ("ICTA") as meaning liabilities as calculated for

the purposes of the Insurance Prudential Sourcebook, a part of the FSA's Handbook made under powers in Financial Services and Markets Act 2000. For long-term business which is not life assurance business, a company will use its Companies Act accounts in determining the profit. But the amount of liabilities to policy holders in those accounts is also calculated by reference to the FSA's Rules.

7.2 In September 2006 the FSA published a Computation paper (06/16) which proposed some relaxations in its rules for calculating liabilities. The proposals were received enthusiastically by the insurance industry – they meant among other things that more surplus and hence more profit could be declared for the year ended 31 December 2006 than would otherwise be the case. The additional amounts were estimated to be in the £billions in CP 06/16.

7.3 Such a one-off release of profit would however also give rise to an exceptional tax liability. CP 06/16 recognised that there would be tax implications and invited the industry to discuss these with HM Revenue and Customs. The Government has agreed that the impact of the profit release arising from the changes in calculation of reserves should be mitigated.

7.4 This Order takes the first step towards mitigating the impact. It is being made now, and in advance of a comprehensive Order, because HMRC has been advised that unless a statutory instrument has been "substantially enacted" by the end of 2006, companies would have to provide for tax in their accounts on the basis that there is no mitigation. "Substantially enacted" is interpreted, in the case of UK Statutory Instrument, to mean "made and laid".

7.5 There is no need to breach the 21-day Rule, both because of this interpretation of "substantially enacted" and because the power in section 431A(2) ICTA allows an Order made under subsection (1) to have a limited retrospective effect (so that its effect coincides with that of the relevant FSA changes)

7.6 It is not appropriate to amend tax law otherwise than through legislative change, so no alternative avenues of achieving the objective have been explored.

7.7 The contents of the Order have been discussed with the insurance industry at whose request the Order is being laid at this time.

7.8 Guidance on the primary legislation inserted by the Order will be included in HMRC's Life Assurance Manual, and as a temporary measure, in advance guidance which will be made available to the industry as well as to HMRC staff.

8. Impact

8.1 A Regulatory Impact Assessment has not been published for this instrument as no impact on the private or voluntary sector is foreseen

8.2 The Order prevents an inappropriate tax charge arising.

9. Contact

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