HM Revenue & Customs

General Insurance: Claims Equalisation Reserves

Who is likely to be affected?

General insurance companies who maintain claims equalisation reserves (CERs) and corporate and partnership members of Lloyd's who maintain equivalent reserves.

General description of the measure

This measure will repeal the current legislation for the tax treatment of CERs. Regulations will be made by HM Treasury to cover equivalent reserves maintained by corporate and partnership members of Lloyd's.

The measure will introduce a rule to tax built-up CERs in equal amounts over a six year period commencing from the date the Solvency II Directive solvency requirements come into force.

Policy objective

This measure deals with the taxation impacts arising from the removal of the regulatory requirement for general insurers to maintain CERs as a result of the implementation of the Solvency II Directive. The measure repeals the current tax rules and the parallel rules for Lloyd's and provides for a transitional period over which the built-up reserves will be charged to tax.

Background to the measure

This measure was originally announced at Budget 2011. There is currently a regulatory requirement for general insurance companies (but not Lloyd’s members) to maintain CERs in respect of certain lines of business. From 1996 general insurers were allowed to treat amounts transferred into CERs as tax deductible (and amounts transferred out were treated as taxable receipts). In 2009, rules were introduced to allow equivalent deductions for Lloyd’s corporate and partnership members.

The relief currently available is dependent on the regulatory requirement for general insurance companies to maintain CERs. However, under Solvency II that requirement will be withdrawn.

An informal consultation took place between April and August 2011 with an industry working group. Both the Association of British Insurers (ABI) and Lloyd's, representing general insurance companies and corporate and partnership members at Lloyd's, have been included in the consultation process. Following this consultation, the Government has decided to introduce legislation to repeal the CER tax provisions and to tax built-up reserves over a transitional six year period.

Detailed proposal

Operative date

The measure will have effect from the date Solvency II comes into force, which is expected to be 1 January 2014.

Current law

For general insurance companies the tax treatment of equalisation reserves is governed by sections 444BA to 444BD of the Income and Corporation Taxes Act 1988.

Section 47 of the Finance Act 2009 and The Lloyd's Underwriters (Equalisation Reserves) (Tax) Regulations 2009 (SI 2009/2039) provide for the same tax treatment for Lloyd's corporate and partnership members that maintain an equivalent reserve to that maintained by general insurance companies.

The current law allows for a tax deduction for transfers into reserves and taxes transfers out of reserves.

Proposed revisions

Legislation will be introduced in Finance Bill 2012 to make these changes for general insurance companies and by secondary legislation in the case of Lloyd's.

With effect from the date Solvency II capital requirements come into force built-up reserves will be taxed over a six year period. The release will have effect in relation to accounting periods ending on or after an appointed day specified in an order made by HM Treasury. The appointed day will be the date Solvency II comes into force, once it is confirmed.

Summary of impacts

<table>
<tr><td rowspan="3">Exchequer impact (£m)</td><td>2011-12</td><td>2012-13</td><td>2013-14</td><td>2014-15</td><td>2015-16</td></tr>
<tr><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td colspan="5">This measure is expected to increase receipts by approximately £90 million per annum. The final costing will be subject to scrutiny by the Office for Budget Responsibility, and set out at Budget 2012.</td></tr>
<tr><td>Economic impact</td><td colspan="5">No impact on investment, employment, or consumption is anticipated. The objective is to address the changed circumstances brought about by the removal of a regulatory requirement which has an associated tax deduction. It is not designed to affect underlying economic behaviour.</td></tr>
<tr><td>Impact on individuals and households</td><td colspan="5">The measure will not impact on individuals and households as it applies to general insurance companies and Lloyd's corporate and partnership members only.</td></tr>
<tr><td>Equalities impacts</td><td colspan="5">The measure applies to general insurance companies and Lloyd's corporate and partnership members only. No impacts on people with protected characteristics are anticipated.</td></tr>
<tr><td>Impact on business including civil society organisations</td><td colspan="5">The measure applies to general insurance companies and Lloyd's corporate and partnership members only. No impact on other businesses is anticipated.
Compliance and administrative costs are anticipated to be negligible. The measure does not require companies to collect and process additional data.</td></tr>
<tr><td>Operational impact (£m) (HMRC or other)</td><td colspan="5">There will be some training/familiarisation costs for HMRC specialists.</td></tr>
<tr><td>Other impacts</td><td colspan="5">There are no other impacts anticipated.</td></tr>
</table>

Monitoring and evaluation

Tax returns will provide the information required to make a reliable assessment of the tax impact of the new rules.

HMRC has an established programme of liaison with industry which will capture issues around implementation and ongoing compliance and administrative costs.

Further advice

If you have any questions about this change, please contact David Moran on 020 7147 2612 (email: david.moran@hmrc.gsi.gov.uk).

1 Abolition of relief for equalisation reserves: general insurers

(1) Sections 444BA to 444BD of ICTA (equalisation reserves) are repealed.

(2) In consequence of this repeal, omit—
- (a) in TMA 1970, in the second column of the table in section 98, the entry relating to regulations under section 444BB of ICTA and the entry relating to regulations under section 444BD of ICTA,
- (b) in FA 1996, section 166 and Schedule 32,
- (c) in FA 2003, in section 153(1)(a), the words "444BB(3)(b),",
- (d) in CTA 2009, paragraphs 155 and 156 of Schedule 1, and
- (e) in TIOPA 2010, paragraph 9 of Schedule 8.

(3) The amendments made by this section have effect in relation to accounting periods ending on or after such day ("the specified day") as is specified in an order made by the Treasury.

(4) In the case of a company's existing equalisation or equivalent reserve—
- (a) an amount equal to one-sixth of the amount of the reserve is to be treated as a receipt of the company's business in the calendar year in which the specified day falls, and
- (b) an amount equal to one-sixth of the amount of the reserve is to be treated as a receipt of the company's business in each of the next five calendar years.

(5) If a company has different accounting periods falling in a calendar year, the receipt is apportioned between those periods in proportion to the number of days of the calendar year falling in those periods.

(6) If a company ceases to carry on the business before the full amount of its existing equalisation or equivalent reserve is dealt with as mentioned in subsection (4), the remaining balance of the reserve is to be treated as a receipt of the company's business in the accounting period in which the company ceased to carry it on.

(7) For the purposes of this section—
- (a) "equalisation reserve", in relation to a company, means the equalisation reserve in respect of a business which the company was required, by virtue of equalisation reserves rules (within the meaning of section 444BA of ICTA), to maintain,
- (b) "equivalent reserve" means an equivalent reserve (within the meaning of section 444BD of ICTA) in relation to which section 444BA of ICTA applied,
- (c) a company's "existing" equalisation or equivalent reserve means the equalisation or equivalent reserve as it stood immediately before the first accounting period of the company ("the relevant accounting period") in relation to which the amendments made by this section have effect (but see subsection (8)), and

(d) references in this section to the company's business are to the business in respect of which the equalisation or equivalent reserve was maintained.

(8) If—

(a) a company has made an election under section 444BA(4) of ICTA in relation to an accounting period ending before the specified day, and

(b) an amount would, but for this section, have been carried forward to the relevant accounting period of the company as a deductible amount,

that amount is not to be carried forward to that period as a deductible amount but is instead to be deducted from the amount of the equalisation or equivalent reserve as it stood immediately before that period.

(9) References in this section to section 444BA of ICTA include that section as modified by regulations made under section 444BB or 444BC of that Act.

2 Deemed receipts under s.1(4): double taxation relief

(1) This section applies if—

(a) a receipt is treated as arising to a company's business in an accounting period as a result of section 1(4), and

(b) the company carries on business through a permanent establishment outside the United Kingdom by reference to which double taxation relief is afforded in respect of any income or gains.

(2) For the purpose of calculating the profits or losses by reference to which double taxation relief is afforded for the accounting period, only the appropriate proportion (if any) of the receipt is to be taken into account.

(3) The appropriate proportion of the receipt is equal to the mean of each proportion found for each relevant period (if any).

(4) A proportion for a relevant period is the proportion which the PE's premium income for the period bears to the company's premium income for the period.

(5) For the purposes of this section—

"the company's premium income", in relation to a relevant period, means the total amount of net premiums written in the course of the business mentioned in subsection (1)(a) arising in that period,

"the PE's premium income", in relation to a relevant period, means the total amount of net premiums written in the course of that business arising in that period that are attributable to the permanent establishment, and

a "relevant period" means an accounting period of the company in relation to which each of the following conditions is met—

(a) section 444BA of ICTA has applied in relation to the accounting period,

(b) the business mentioned in subsection (1)(a) has been carried on through the permanent establishment in the accounting period, and

(c) the accounting period is the company's last accounting period in relation to which section 444BA of ICTA applied or is one that falls wholly or partly in the period of six years ending with the day on which that last accounting period ended.

(6) In subsection (5)—

(a) "net premiums written" means gross premiums written net of reinsurance premiums payable under reinsurance ceded, and

(b) references to section 444BA of ICTA include that section as modified by regulations made under that Act.

3 Abolition of relief for equalisation reserves: Lloyd's corporate members etc

(1) Regulations made by the Treasury under section 47 of FA 2009 (equalisation reserves for Lloyd's corporate and partnership members) that revoke previous regulations made under that section may include provision corresponding to the provision made by section 1(4) to (8), subject to such modifications as may be made in the regulations.

(2) Section 47 of FA 2009 is repealed.

(3) That repeal has effect in relation to accounting periods ending on or after such day ("the specified day") as is specified in an order made by the Treasury.

(4) Subsections (2) and (3) are not to affect the operation of any transitional or saving provision included (whether as a result of this section or otherwise) in regulations made under section 47 of FA 2009 that revoke previous regulations made under that section so far as the provision remains capable of having effect in relation to times falling on or after the specified day.

EXPLANATORY NOTE

ABOLITION OF RELIEF FOR EQUALISATION RESERVES: GENERAL INSURERS

SUMMARY

1. This clause repeals sections 444BA to 444BD of the Income and Corporation Taxes Act 1988 ('ICTA') that provide for tax relief for equalisation reserves maintained by general insurance companies. It also sets out transitional provisions following on from the repeal.

DETAILS OF THE CLAUSE

2. Subsection (1) repeals sections 444BA to 444BD of ICTA.

3. Subsection (2) sets out consequential repeals arising from the repeal of sections 444BA to 444BD of ICTA.

4. Subsection (3) provides that the amendments made by this clause shall have effect in relation to accounting periods ending on or after a date to be specified in a Treasury order.

5. Subsection (4) provides that one sixth of a company's existing equalisation, or equivalent reserve, is to be treated as a receipt of the company's business in each of the 6 calendar years, beginning with the calendar year in which the date specified in an order made by the Treasury falls.

6. Subsection (5) provides that if a company has different accounting periods falling in a calendar year, the receipt is to be apportioned between those periods by reference to the number of days of the calendar year falling in those periods.

7. Subsection (6) provides that if a company ceases to carry on the business before the expiry of the 6 year period referred to in subsection (4), any remaining balance of the existing equalisation, or equivalent reserve, is to be treated as a receipt of the company's business in the accounting period in which the company ceased to carry it on.

8. Subsection (7) defines the terms "equalisation reserve", "equivalent reserve", "existing equalisation or equivalent reserve" and "the company's business".

9. Subsection (8) sets out the tax treatment where a company has made an election under section 444BA(4) of ICTA for an accounting period ending before the date specified in a Treasury order, and such a sum

would have been carried forward as a deductible amount. The amount shall be deducted from the amount of the equalisation or equivalent reserve as it stood immediately before the accounting period to which it would have been carried forward.

10. Subsection (9) provides that references to section 444BA of ICTA include that section as modified by sections 444BB or 444BC of that Act.

BACKGROUND NOTE

11. There is currently a regulatory requirement for general insurance companies (but not members of Lloyd's) to maintain equalisation reserves in respect of certain lines of business. From 1996, amounts transferred into equalisation reserves were made tax deductible, and transfers out were treated as taxable receipts of the company's business.

12. The relief currently available is dependent on the regulatory requirement for general insurance companies to maintain equalisation reserves. As a result of the European Union Solvency II Directive that requirement will be withdrawn.

13. An informal consultation took place between April and August 2011 with an industry working group. Both the Association of British Insurers and Lloyd's, representing general insurance companies and corporate and partnership members at Lloyd's, have been included in the consultation process.

14. Taking into account these discussions, the Government has decided to repeal the legislation that allows tax relief for equalisation reserves. The Government has also decided to introduce a transitional period for the release of built-up reserves that involves spreading that release in equal instalments over a 6 year period, commencing from the date that the Solvency II capital requirements come into force.

15. If you have any questions about this change, or comments on the legislation, please contact David Moran on 020 7147 2612 (email david.moran@hmrc.gsi.gov.uk).

EXPLANATORY NOTE

DEEMED RECEIPTS UNDER SECTION 1(4): DOUBLE TAXATION RELIEF

SUMMARY

1. This clause provides rules for the amount to be brought into account in the calculation of double taxation relief where a receipt arises under section 1(4) (“Abolition of relief for equalisation reserves: general insurers”).

DETAILS OF THE CLAUSE

2. Subsection (1) provides that this section applies if a receipt arises to a company as a result of section 1(4) and that company carries on business through a permanent establishment (‘PE’) outside the United Kingdom for which double taxation relief is due in respect of any income or gain.

3. Subsection (2) provides that only the appropriate proportion (if any) of the receipt is to be taken into account in calculating the profits or losses on which double taxation relief is calculated.

4. Subsection (3) defines the appropriate proportion of the receipt as being equal to the mean of each proportion found for each relevant period.

5. Subsection (4) defines a proportion for a relevant period as the proportion of the company’s premium income constituted by the PE’s premium income for the same period.

6. Subsection (5) provides definitions of “the company’s premium income”, “the PE’s premium income” and a “relevant period”.

7. Subsection (6) defines “net premiums written” and provides that references to section 444BA of the Income and Corporation Taxes Act of 1988 include that section as modified by regulations made under that Act.

BACKGROUND NOTE

8. There is currently a regulatory requirement for general insurance companies (but not members of Lloyd’s) to maintain equalisation reserves in respect of certain lines of business. From 1996, amounts transferred into equalisation reserves were made tax deductible and

transfers out were treated as taxable receipts of the company's business.

9. The relief currently available is dependent on the regulatory requirement for general insurance companies to maintain equalisation reserves. As a result of the European Union Solvency II Directive that requirement will be withdrawn.

10. An informal consultation took place between April and August 2011 with an industry working group. Both the Association of British Insurers and Lloyd's, representing general insurance companies and corporate and partnership members at Lloyd's, have been included in the consultation process.

11. Taking into account these discussions, the Government has decided to repeal the legislation that allows tax relief for equalisation reserves. The Government has also decided to introduce a transitional period for the release of built-up reserves that involves spreading that release in equal instalments over a 6 year period commencing from the date that the Solvency II capital requirements come into force.

12. If you have any questions about this change, or comments on the legislation, please contact David Moran on 020 7147 2612 (email: david.moran@hmrc.gsi.gov.uk).

EXPLANATORY NOTE

ABOLITION OF RELIEF FOR EQUALISATION RESERVES: LLOYD'S CORPORATE MEMBERS ETC.

SUMMARY

1. This clause repeals section 47 of the Finance Act 2009 ('FA 2009'). The repeal is not effective in relation to transitional provisions being made under this section which are capable of having effect after the date of the repeal.

DETAILS OF THE CLAUSE

2. Subsection (1) provides that regulations made by the Treasury under section 47 of FA 2009 that revoke previous regulations made under that section may include provisions corresponding to the provisions made by section 1(4) to (8) subject to any modifications specified in the regulations.

3. Subsection (2) repeals section 47 of FA 2009.

4. Subsection (3) provides that the repeal shall have effect for accounting periods ending on or after a date specified in a Treasury order.

5. Subsection (4) provides that the repeal of section 47 of FA 2009 shall not affect any transitional or savings provisions made under section 47 in so far as those transitional or savings provisions are capable of having effect after the date specified in a Treasury order.

BACKGROUND NOTE

6. There is currently a regulatory requirement for general insurance companies (but not members of Lloyd's) to maintain equalisation reserves in respect of certain lines of business. From 1996, amounts transferred into equalisation reserves were made tax deductible and transfers out were treated as taxable receipts of the company's business.

7. Section 47 FA 2009 provided a power to apply similar treatment to Lloyd's corporate and partnership members. The power was used in 2009 to make regulations (The Lloyd's Underwriters (Equalisation Reserves) (Tax) Regulations 2009 (SI 2009/2039)) to allow Lloyd's corporate and partnership members to calculate and hold an equivalent reserve for tax purposes only. Therefore, as with general insurance companies, amounts transferred into an equivalent reserve

were made tax deductible and transfers out were treated as taxable receipts of the member's business.

8. The relief currently available to general insurance companies is dependent on the regulatory requirement for those companies to maintain equalisation reserves. As a result of the European Union Solvency II Directive that requirement will be withdrawn.

9. An informal consultation took place between April and August 2011 with an industry working group. Both the Association of British Insurers and Lloyd's, representing general insurance companies and corporate and partnership members at Lloyd's, have been included in the consultation process.

10. Taking into account these discussions, the Government has decided to repeal the legislation that allows tax relief for equalisation reserves. The Government has also decided to introduce a transitional period for the release of built-up reserves that involves spreading that release in equal instalments over a 6 year period commencing from the date that the Solvency II capital requirements come into force.

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