EXPLANATORY MEMORANDUM TO

THE TAXATION OF REGULATORY CAPITAL SECURITIES (AMENDMENT) REGULATIONS

2015 No. [XXXX]

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

2. Purpose of the instrument

2.1 These Regulations amend the Taxation of Regulatory Capital Securities Regulations 2013 (S.I. 2013/3209, "the RCS Regulations").

2.2 These Regulations provide that restricted Tier 1 (RT1) instruments issued to meet Article 69(a)(iii) or (b) of the Commission Delegated Regulation (EU) 2015/35 (as amended from time to time) are brought within the RCS Regulations. Updates are also made as a consequence of Part 5 of the Corporation Tax Act 2009 by the Finance Act 2015.

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

3.1 None

4. Legislative Context

4.1 The instrument is made to provide certainty of tax treatment for regulatory capital securities issued for the purposes of compliance with Commission Delegated Regulation (EU) 2015/35, which gives effect to the Solvency II Directive 2009/138/EC of the European Parliament and of the Council.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

To be completed post consultation.

7. Policy background

What is being done and why

7.1 The EU Solvency II Directive and changes made to Part 5 of the Corporation Tax Act 2009 by the Finance Act 2015 mean that changes are required to ensure the RCS Regulations provide the correct tax treatment for financial institutions issuing regulatory compliant securities.

Solvency II

7.2 The EU Solvency II Directive introduces a new, harmonised regulatory regime across the EU. As part of this, from 1 January 2016, insurers will be required to hold new types of regulatory capital designed to boost loss absorbency and improve financial stability.

7.3 The UK Regulators, the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) are changing their rules to transpose some of the articles and harmonise with the Directive. These regulatory changes give rise to uncertainty of tax treatment for Solvency II compliant restricted Tier 1 capital instruments that insurers may need to issue.

7.4 This instrument amends the RCS Regulations to apply restricted Tier 1 capital instruments, providing for insurers' Solvency II instruments that are issued as debt to represent a loan relationship with the associated tax treatment of amounts representing interest to follow.

Modernising the taxation of corporate debt and derivative contracts

7.5 In consequence of changes made to Part 5 of the Corporation Tax Act 2009 by the Finance Act 2015, the Regulations amend the term "carrying value" to "tax-adjusted carrying value".

7.6 Also as a consequence of the changes outlined in 7.4 above, a new Regulation is inserted to provide for circumstances where in accordance with generally accepted accounting practice (GAAP) the accounts show an RCS amount in equity or shareholders' funds for an accounting period, rather than as income it will be treated for the purposes of the loan relationship regime as if it were included in the profit and loss account. However, this excludes exchange gains or losses recognised in the company's accounts.

Transitional provisions

7.7 These Regulations take effect for accounting periods commencing on or after 1 January 2016. Where regulatory capital instruments have been be issued prior to this date, this instrument provides that any changes in accounting treatment are taken into account when calculating the amount to be brought into account for the purposes of Part 5 of CTA 2009.

Consolidation

7.8 There are no plans to consolidate the revised Regulations in the immediate future.

8. Consultation outcome

8.1 *To be completed post consultation.*

9. Guidance

9.1 Guidance on this change will be incorporated into HM Revenue and Customs' Corporate Finance Manual in due course.

10. Impact

10.1 These regulations apply to businesses issuing regulatory capital securities, typically financial institutions such as banks, building societies and insurers. There is no impact on charities or voluntary bodies.

10.2 There is no impact on the public sector.

10.3 A Tax Information and Impact Note covering this instrument will be published on the GOV.UK website at https://www.gov.uk/government/collections/tax-information-and-impact-notes-tiins.

11. Regulating small business

11.1 The legislation may apply to small business. Insurers with gross premium incomes below €5m and gross technical provisions below €25m are Non-Directive' firms which are excluded from Solvency II.

11.2 This measure will only impact on insurance companies that are subject to the Solvency II Directive, which may need to exchange existing capital instruments for new regulatory compliant instruments.

11.3 If small businesses were excluded from these Regulations they would be disadvantaged.

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. Regular communication with the industry will capture issues around implementation and ongoing compliance and administrative costs.

13. Contact

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