

**EXPLANATORY MEMORANDUM TO**  
**THE TAXATION OF REGULATORY CAPITAL SECURITIES (AMENDMENT)**  
**REGULATIONS**

**2015 No. XXXX**

**1. Introduction**

1.1 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”). The purpose of this instrument is to make provision in relation to the tax consequences of securities issued to meet new regulatory requirements imposed by EU legislation. The Regulations will provide issuers and holders of these new forms of regulatory capital which insurers will be required to issue with certainty of tax treatment.
- 2.2 These Regulations also make amendments required in consequence of the amendments to Part 5 of the Corporation Tax Act 2009 by the Finance (No.2) Act 2015.

**3. Matters of special interest to Parliament**

*Matters of special interest to the Select Committee on Statutory Instruments*

3.1 None.

*Other matters of interest to the House of Commons*

3.2 Disregarding minor or consequential changes, the territorial application of this instrument includes Scotland and includes Northern Ireland and is not a financial instrument that relates exclusively to England, Wales and Northern Ireland.

**4. Legislative Context**

4.1 The instrument is made using the power contained within Section 221 Finance Act 2012 which allows Regulations to be made to deal with the tax consequences in relation to securities of regulatory changes imposed through EU or UK legislation to provide certainty of tax treatment for certain categories of 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. Extent and Territorial Application**

- 5.1 This instrument extends to all of the United Kingdom.
- 5.2 These regulations apply to all of the United Kingdom.

## **6. European Convention on Human Rights**

6.1 The Financial Secretary to the Exchequer, David Gauke MP, has made the following statement regarding Human Rights:

“In my view the provisions of the Taxation of Regulatory Capital Securities (Amendment) Regulations 2015 are compatible with the Convention rights.”

## **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 (No.2) Act 2015 necessitate 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 issue 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 Tier 1 and Tier 2 capital instruments that insurers will need to issue.

7.4 This instrument amends the RCS Regulations to ensure that these new types of regulatory capital are treated as debt for tax purposes and ensures parity of treatment with equivalent types of regulatory capital issued by banks and building societies under the Basel III requirements, which are adopted in Europe via the Capital Requirements Directive IV and the Capital Requirements Regulation.

### *Modernising the taxation of corporate debt and derivative contracts*

7.5 As a result of changes made to Part 5 of the Corporation Tax Act 2009 by the Finance Act 2015, the Regulations also update the RCS Regulations to reflect certain consequential amendments.

7.6 Also as a result of the changes outlined in 7.5, a new regulation is inserted to provide for circumstances where in accordance with generally accepted accounting practice (GAAP) the accounts show an amount in respect of a regulatory capital instrument in equity or shareholders' funds for an accounting period, rather than as an item of income or expense it will be treated for the purposes of the loan relationship regime as if it were recognised in determining profit or loss in the period. However, this excludes exchange gains or losses that are recognised in certain specified statements.

### *Transitional provisions*

7.7 These Regulations take effect for accounting periods commencing on or after 1 January 2016. Where regulatory capital instruments have been issued prior to this date and fall to be loan relationship absent these regulations, 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 the Corporation Tax

Act 2009. This ensures that profits and losses on such instruments are brought into account once and only once.

### ***Consolidation***

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

## **8. Consultation outcome**

8.1 A consultation was held between 15 July and 9 September 2015 to enable those businesses potentially affected by the Regulations to review a draft of the proposed Regulations. Written comments and evidence was provided by various respondents and considered together with opinions gathered at an open meeting held in on 8 August 2015. As a result of representations received and evidence provided, the scope of the Regulations has been extended to include both Solvency II compliant Tier 2 instruments.

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

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 applies to activities that are undertaken by small businesses. 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**

- 13.1 Hayley Moran at HM Revenue and Customs Telephone: 03000 514795 or email: [hayley.moran@hmrc.gsi.gov.uk](mailto:hayley.moran@hmrc.gsi.gov.uk) can answer any queries regarding the instrument.