EXPLANATORY MEMORANDUM TO

THE LLOYD'S UNDERWRITERS (TRANSITIONAL EQUALISATION RESERVES) (TAX) REGULATIONS 2015

2015 No. 1983

1. Introduction

1.1 This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs, on behalf of HM Treasury, and is laid before the House of Commons by Command of Her Majesty.

1.2 This memorandum contains information for the Select Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 The instrument revokes the Lloyd's Underwriters (Equalisation Reserves) (Tax) Regulations 2009 (S.I. 2009/2039) ("the 2009 Regulations") and the Insurance Companies (Reserves) (Tax) Regulations 1996 (S.I. 1996/2991) and makes transitional provisions in respect of "equivalent Lloyd's reserves" maintained by corporate or partnership members of Lloyd's.

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

3.1 This is the first exercise of powers under section 30(1) of the Finance Act 2012 (c. 14).

Other matters of interest to the House of Commons

3.2 As this instrument is subject to the negative procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

4. Legislative Context

4.1 General insurers in the UK may be insurance companies or members of the Lloyd's insurance market. Since 1996, general insurance companies have been entitled by virtue of sections 444BA to 444BD of the Income and Corporation Taxes Act 1988 to tax relief on amounts reflected in the equalisation reserves they are required by regulation to maintain. The Lloyd's insurance market operates somewhat differently from that applying to general insurance companies and Lloyd's members were not required to maintain these reserves.

4.2 The 2009 Regulations provided that the main equalisation reserves tax relief rules applied, suitably amended, to equivalent reserves maintained by corporate and partnership members of the Lloyd's insurance market.

4.3 The rationale underpinning EU insurance legislation in general is to facilitate the development of a Single Market in insurance services in the EU, whilst at the same time securing an adequate level of consumer protection.

4.4 The European Parliament and the Council of the European Union's Directive 2009/138/EC of 25 November 2009 on the taking-up and pursuit of the business of insurance and reinsurance ("the Solvency II Directive") will set out new, stronger EU-wide requirements on capital adequacy and risk management for insurers with the aim of increasing protection for policyholders. The strengthened regime aims to reduce the possibility of consumer loss or market disruption in insurance.

4.5 The new regime is scheduled to come into force on 1 January 2016 when it will replace the existing Solvency I Directive and the current regulatory regime for insurance supervision for firms in the UK.

4.6 When the Directive comes into force the Prudential Regulation Authority will no longer require general insurance companies to maintain equalisation reserves.

4.7 This is the first exercise of the power to make regulations provided for in section 30 of the Finance Act 2012. The power permits regulations to be made revoking the 2009 Regulations. It also permits the making of provisions corresponding to those made in respect of general insurance companies for the taxation consequences arising from the removal of the regulatory requirement for such companies to maintain equalisation reserves.

5. Extent and Territorial Application

5.1 The extent of this instrument is the United Kingdom.

5.2 The territorial application of this instrument is the United Kingdom.

6. European Convention on Human Rights

6.1 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 When the Solvency II Directive comes into force there will no longer be a regulatory requirement for general insurance companies to maintain equalisation reserves.

7.2 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. Taking into account these discussions, the Government has decided to repeal the legislation that allows tax relief for equalisation reserves.

7.3 This instrument revokes the 2009 Regulations and provides that the sum of the "transitional equivalent reserve" shall be taxed. The transitional reserve is the excess of total deductions for tax in respect of equivalent reserves over total taxable receipts in respect of equalisation reserves for all accounting periods which end on or after 31 December 2008 but end before 1 January 2016.

7.4 The Government has also decided that the transitional equivalent reserve will be apportioned over a 6 year period with each proportion being treated as a taxable receipt in the year of apportionment.

Consolidation

7.5 This instrument does not amend any other instrument, but it does revoke the 2009 Regulations and the Insurance Companies (Reserves) (Tax) Regulations 1996 (S.I. 1996/2991).

8. Consultation outcome

8.1 Officials have been in informal consultation with the representatives of Lloyd's on this instrument since early 2010.

8.2 Drafts of this instrument were published for consultation on 20 February 2012.

8.3 The drafting of this instrument reflects the comments made by respondents to those informal consultations.

9. Guidance

9.1 Guidance will be published to accompany this Instrument.

10. Impact

10.1 The impact on business, charities or voluntary bodies is limited to Lloyd's corporate and partnership members only. No impact on other businesses, charities or voluntary bodies is expected.

10.2 The impact on the public sector is negligible.

10.3 A Tax Information and Impact Note has not been prepared for this instrument as it gives effect to previously announced policy.

11. Regulating small business

11.1 The legislation applies to activities that are undertaken by small businesses.

11.2 To minimise the impact of the requirements on small businesses (employing up to 50 people), the approach taken is to consult with Lloyd's to determine whether any special provisions are required for smaller members of the Lloyd's market.

11.3 The basis for the final decision on what action to take to assist small business is that compliance and administrative costs are anticipated to be negligible. The instrument does not require Lloyd's corporate or partnership members to collect and process additional data. The decision was therefore that special provisions were not required.

12. Monitoring & review

12.1 The costs and administrative burden of the relief will be subject to internal review by HM Revenue and Customs at regular intervals.

13. Contact

13.1 David Moran at Her Majesty's Revenue and Customs, telephone: 03000 585989 or email: david.moran@hmrc.gsi.gov.uk can answer any queries regarding the instrument.