AFM tax training day

Corporation tax training

28 June 2018

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Loss reform
Pros and cons of legislative changes

Advantages	Disadvantages
Carry forward against different income types	Restriction on the total profit which can be sheltered with brought forward losses
Carry forward and group relieve	
More flexibility over the level of offset in each period	

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Loss reform
Basic allowance example

Losses	Regime	
	Old	New
Year 1:		
Loss	£(10)m	£(10)m
Year 2:		
Profit	£10m	£10m
Less: loss relief	£(10)m	£(7.5)m*
	£nil	£2.5m
* Loss utilisation:		
Basic allowance + (Profits less Basic Allowance)*50%		
£5m + ((£10m - £5m)*50%)		

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Corporate interest restriction OECD BEPS Action 4

OECD BEPS Action 4

The OECD is concerned that multinational groups are able to erode their tax base with tax interest expense deductions

BEPS Action 4 attempts to counteract BEPS risks in relation to interest cost in various key scenarios:

- to generate i/c interest deductions greater than the group's third party interest expense
- to fund the generation of tax exempt income

UK CIR Regime

- The new Corporate Interest Restriction ("CIR") legislation is the UK's implementation of BEPS Action 4
- Replaces the Worldwide Debt Cap rules

Financial services

- Broadly considered that insurance groups should be in a net interest income position due to the nature of their business.
- As such, CIR rules should have a limited impact on insurance groups.
- But should consider the Fair Value election

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Corporate interest restriction
5 Key steps

- There are five key steps required under the CIR regime
- We recommend all insurance groups perform the first two steps

	Step	Comments
1	Determine the worldwide group	The CIR rules apply at the level of a "worldwide group" so your first step is to determine: (i) the worldwide group (and the UK CT companies); (ii) the financial statements that are to be used by the group for CIR purposes; and (iii) the group's period of account.
2	Calculate the group's Aggregate Net Tax Interest Income ("ANTII") or Expense ("ANTIE")	Key here: is interest "income" > "expense" income? **Most insurance groups are in ANTII position and go straight to step 5**

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Corporate interest restriction
5 Key steps

	Step	Comments
3	Calculate the CIR disallowance (or reactivation)	If ANTIE < £2m, there should be no disallowance. If ANTIE > £2m, assess if further relief under Fixed Ratio and / or Group Ratio methods Determine CIR disallowance.
4	Allocate the disallowance	Which UK companies will have to add back interest in the computations.
5	Comply with administrative rules	Comply with administrative requirements.

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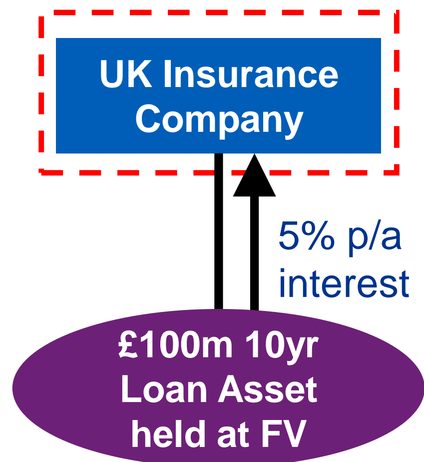
Corporate interest restriction
Fair value accounting election



Background

- UK CT-paying insurance company holds LR creditor (borrowing) relationship(s) accounted for at fair value

Operative Effect of Election

- Tax-interest income/expense amounts to be determined on an "amortised cost basis" – therefore, reduced volatility

Tax Interest Income (Expense) recognised in respect of the loan				
Year	**2017**	**2018**	**2019**	**2020**
No Election (FV)	£7m	£8m	£4m	£3m
With Election (Am Cost)	£5m	£5m	£5m	£5m

Election

- Irrevocable election must be made within 12 months from the end of the accounting period

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Corporate interest restriction
What the insurance market is doing

All insurance group's should:

1. Undertake a review to identify the group, the relevant financial statements, and the period of account; and
2. Perform a high level calculation to ensure there is an ANTII position, or ANTIE is < £2m

Insurance groups should consider the fair value election to smooth out volatility that may arise.

We see the insurance space leaning towards appointing a nominated company, and filing Abbreviated IRRs – which allows groups to submit a full IRR up to 5 years later.

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LAM manual rewrite
Update

What has happened

HMRC have been in consultation with the ABI, the Big 4 and the Institute of Actuaries

The update is to refresh the manual:

- for recent legislation changes: CIR, loss reform, SSE etc.
- to improve the useability of the manual:
  - e.g. facilitate google searches;
  - where possible, each section should stand on its own without extensive cross referencing to other sections
- Currently, there are no specific Friendly Society sections
- There are discussions about whether agreed commercial allocations should be revisited

What will happen

- A wider, formal consultation is expected to commence later this year

Next steps

- Critical that text is scrutinised
- Lobby for specific Friendly Society specific sections – invaluable guidance

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BLAGAB reinsurance regulations

Issue

- Imputed interest on cedant that reinsures BLAGAB out of the UK
- Regulations were not replaced on introduction of the new life tax regime
- Old regulations restrictive and required complicated calculation

Update

- New regulations (2018 SI 538) made and apply to re-insurance arrangements entered into on/after 1 June 2018.
- No imputation where reinsurers return is effectively taxed in the UK
- Simpler calculation, but still contract by contract with true up at the end
- Will allow a wider range of commercial reinsurance arrangements to proceed without a tax impediment.

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BLAGAB reinsurance regulations

Scope

Need to consider 'excluded business' and prescribed arrangements

But broadly no imputation if business:

- is within 90% group
- non-BLAGAB, pre-2013 protection business or immediate needs annuities
- BLAGAB is negligible part of the reinsurance contract
- a 'non-investment' risk reinsurance arrangement
- the cedant is subject to I-E tax on the 'backing assets' (provided that there is no I-E deduction to the reinsurer for use of the assets)

It may be commercially possible for many transactions to proceed using one or more reinsurance contracts each of which falls into one or more of the categories above.

Note: the rules are subject to an unallowable purpose provision where there is a tax avoidance purpose to the arrangements.

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BLAGAB reinsurance regulations

Tax charge on cedant

- if a company enters into a reinsurance arrangement as cedant which does not fall into an exemption then liability to an I-E tax charge under s90 of FA 2012
- charge is the taxable yield equal to the five year UK gilt rate + 4% on the mean BLAGAB liabilities

The true up mechanism

- true up mechanism allows the I-E profit to be trued up to the actual profit in the final period in which the reinsurance is in force
- subject to evidence being provided to HMRC
- disadvantage of imputation through the life of the contract

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IFRIC 23 - uncertain tax positions
Background

It applies to all aspects of income tax accounting where there is an uncertainty regarding the treatment of an item:

- Profit and losses
- Tax bases of assets and liabilities
- Tax losses
- Tax rates

Accounts should reflect the **probable** resolution of the **uncertainty** by recognising, say, an additional tax liability or applying a higher tax rate

No new disclosure requirements in IFRIC 23

Effective for accounting periods **beginning on or after 1 January 2019**. Earlier adoption permitted. Choices are to:

1. Amend comparatives
2. Apply IFRIC 23 with cumulative effect adjusted retained earnings

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IFRIC 23 - uncertain tax positions Definition of an uncertain tax position

Uncertain tax position

An **uncertain tax position** is where there is **uncertainty** over whether that approach will be accepted by the tax authority

Companies should assume the tax authorities have full knowledge of all related information; detection risk is not included in the evaluation.

Accounting for uncertain tax positions

Where it's probable that the uncertain tax treatment would not be accepted, the uncertainty should be recognised in the accounts

For example, by recognising an additional tax liability or applying a higher tax rate.

Measurement

Companies should use the method that best reflects the anticipated outcome. IFRIC 23 prescribes either the "most likely amount" method or the "expected value" method.

The expected value method might be appropriate if there is a range of possible outcomes; otherwise, the most likely amount method may be appropriate

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IFRS 17 Background

IFRS 17 is the new accounting standard for measuring insurance contract liabilities, effective for accounting periods beginning on or after **1 January 2021**,

Reinsurance written and reinsurance held would also be affected

There are three prescribed measurement models

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IFRS 17
Measurement models

Building block approach

- the default measurement model expected to be applied to non-participating life insurance contracts and non-life contracts ineligible for the Premium Allocation Approach

The Premium Allocation Approach

- optional and simplified model applicable to short term contracts and certain multi-year contracts (such as some non-life contracts).
- Similar to IFRS 4 reserving

Variable Fee Approach

- a variation of the BBA mandated for participating life insurance contracts.

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IFRS 17
Four key themes for the tax function

Adjust to new profit profiles and manage volatility in earnings	Tax functions need to understand the impacts on profits Products will have a different profit profile —Profits generally spread but losses recognised immediately —For some ST business, certain indirect acquisitions costs cannot be deferred - may create first year losses —For some LT business, e.g. annuities, previously booked profits could be reversed and deferred into the medium/long term —For with-profits business, profit recognition may be accelerated
Capital requirements	There could be a direct impact on loss absorbency of deferred tax/SCR
Engage HMRC	HMRC are in discussion with insurers about the impact of IFRS 17 Insurers should discuss their expectations within the industry
Data and reporting	**Ledger and systems design should be considered** The measure of **insurance contract revenue changes.** **SAO** and **CbCR thresholds should be double checked**

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Tax disclosures
Public pressure and international developments

Revelations on harmful practices

- ‘LuxLeaks’
- ‘Panama Papers’
- ‘Malta Leaks’
- Pressure from the European Parliament

Existing EU instruments

- Anti Tax Avoidance Directive (ATAD1&2)
- Common Reporting Standard (CRS) in the EU
- Mandatory automatic exchange of information on advance cross-border rulings
- CbCR– public requirement is in the works
- Directive on Double Taxation Dispute Resolution Mechanisms (DTDRM) in the EU
- AMLD4 – UBO registers
- EU blacklist

OECD BEPS

- Action 12 on Mandatory disclosure rules
- Design principles, not minimum standard
- Hallmarks should reflect specific country needs and risks
- Both national and cross-border arrangements
- Multilateral instrument
- OECD peer review for BEPS minimum standards

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Tax disclosures
Anti-Tax Avoidance Directive II ("ATAD")

- Consultation is taking place about the impact of ATAD II on insurers and banks

Currently

- Anti Hybrid rules currently includes an exemption for financial instruments relating to Regulatory Capital Security

Anticipated change

- This exemption is expected to be removed

Who should be affected

- Likely to affect non-UK headed groups where:

(i) regulatory capital is passed down through the group to the UK and UK tax deductions are claimed; and

(ii) Non-UK holder of the security obtains beneficial tax treatment (exempted or underlying tax relief)

When

- From 1 January 2020
- No plans to depart from the implementation programme

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EU MDR
The latest

The Directive on Administrative Cooperation is to be amended to require Member States to implement measures requiring:

- Disclosure of reportable cross border transactions
- Within 30 days of a specified trigger date.
- With quarterly updates
- Effective from 1 July 2020 – but should have retrospective effect from 25 June 2018
- This means reportable arrangements taking place between 25 June 2018 and 1 July 2020 would need to be disclosed by 31 August 2020.
- Penalties which are “effective, proportionate and dissuasive” to be imposed for any infringements.

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EU MDR
What arrangements are in scope?

To be in scope an arrangement must be:

A. **Cross-border**, and

B. **Reportable**

The preamble to the Directive refers to the disclosure of "potentially aggressive tax planning arrangements", but the requirements of the Directive itself appear much broader.

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EU MDR Examples

Example 1

A UK company reinsures with overseas group entity

Example 2

An EU branch of a UK FI transfers its business to a overseas subsidiary as part of its Brexit planning

Example 3

Standardised documentation or structure

⇨ Standard products or structures with tax benefits may require disclosure.

⇨ No exclusion for statutory tax incentives – e.g. tax-advantaged savings products – or routine structures.

Example 4

Deductions for the same depreciation on the asset are claimed in more than one jurisdiction.

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Thank you

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