

**REGULATORY IMPACT ASSESSMENT
LIFE INSURANCE POLICIES ETC-
INFORMATION DUTIES OF INSURERS
Section 83 and Schedule 28 FA 2001**

Statement of Ministerial Approval

I have read the regulatory impact assessment and I am satisfied that
the benefits justify the costs.

Signed by the responsible Minister:

Ruth Kelly
Economic Secretary

Date

**REGULATORY IMPACT ASSESSMENT (RIA)
LIFE INSURANCE POLICIES ETC-
INFORMATION DUTIES OF INSURERS
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Purpose and intended effect

1 Under current rules, life insurance companies are required to deliver a certificate to the Inland Revenue when a chargeable event giving rise to a gain happens in connection with a life insurance policy, contract for a life annuity or capital redemption policy. The current rules do not require insurers to tell the policy holder either the amount of any gains or even that a gain has arisen.

2 The purpose of this measure is to ensure that life insurers always let the policy holder know when a gain has arisen and the amount of that gain. The aim is to provide individual policy holders with the correct information, in an easy to understand format, to help individuals chargeable to tax on the gain to complete their Self Assessment (SA) return and pay the right amount of tax on time. The legislation sets out what information is to be provided but the form in which insurers supply the information to policy holders will be entirely up to them. Because any gain, however small, may give rise to a tax liability, there is no lower limit for cash or gain below which an insurer does not have to send a certificate to a policy holder who has made a gain.

3 The measure will also remove the current obligation on life insurers to notify the Inland Revenue about every gain. In future, insurers will only have to tell the Inland Revenue about the larger gains their policy holders make. For this purpose, insurers will be required to use a form prescribed by the Inland Revenue. Insurers may opt to tell the Inland Revenue about all gains, again in a prescribed form, provided they supply this information using electronic media. Either process will enable the Inland Revenue to handle more easily the information insurers send.

4 The measure will allow insurers to deliver the information to the Inland Revenue, in the way that is most convenient to them, whether that is on paper, on a floppy disc, on magnetic tape or, in time, via the Internet. Previously all certificates had to be sent on paper. This will help the department to meet its PSA objective to ensure that, by 2005, 100% of services are offered electronically.

5 Insurers issue well over a million certificates to the Inland Revenue each year. It is not known how many of these are copied to the policy holder. At present, only a minority of the gains insurers report give rise to further tax liabilities. In future, insurers will send these certificates to policy holders direct in the first instance. For the year of assessment 1998-99 there were approximately 95,000 SA taxpayers who made returns of chargeable event gains. Besides policy holders, the measure potentially affects the 300 or so UK-based companies and Friendly Societies who sell life insurance in the UK.

Although there are roughly 350 UK based insurers authorised to sell insurance here not all of these sell the types of products that give rise to chargeable event gains.

Risks

6 UK-based providers of life insurance currently notify the Inland Revenue about all gains made. Under the new proposals providers of life insurance will notify individual policy holders about the gain instead. The Association of British Insurers (ABI) already encourages its members to tell policy holders about gains. Insurers will have to notify only the larger gains to the Inland Revenue. Giving the policy holder the information they need to know in an easy to understand format will, it is expected, improve compliance in the self assessment of gains. The risk that putting the onus on the taxpayer to report any chargeable event gains will result in a loss of tax to the Exchequer is not thought to be significant. On the contrary, there is evidence from the growth in the number of gains returned since the introduction of the SA regime in 1996/97 that the personal responsibility imposed by SA has had positive compliance benefits. The provision of accurate information to policy holders about their gains can only help with this. The Inland Revenue will retain its powers to audit the books and records of insurers to enable it to check that individual companies are giving both policy holders and the Inland Revenue the correct information.

Options

No change

7 One option was to make no change to the law. Insurers already have to identify all chargeable events, collate the information necessary to calculate the gain and send the information to the Inland Revenue within three months of the event occurring. As a part of their customer service, many insurers already send the policy holder a copy of the information they send to the Inland Revenue and some also calculate the gain. A small number do neither. So while some policy holders are well served, this is at the discretion of the insurer and not all policy holders get the same level of information about their tax position. Doing nothing would not seem a sensible option for the 95,000+ individuals who have to self assess the gains they make.

Non - Regulatory Option

8 Policy holders need this information if they are to self assess the gain. Because they hold the relevant information for commercial reasons, insurers are the best equipped to calculate the gain and have always had the option to do so and tell their policy holders. This practice is recommended by the ABI and is considered to be best practice in the insurance industry. However, with no requirement to tell policy holders the amount of the gain, there are a number of insurers who are still not doing so. The failure over many years to

provide this necessary information to their policy holders points clearly to the need to impose this requirement by statute as a voluntary arrangement is not sufficient.

9 A further reason why it is necessary to retain a statutory requirement for the supply of information to the Inland Revenue is that giving information about policy holders might otherwise be a breach of client confidentiality.

10 Neither the ABI nor the Association of Friendly Societies (AFS) have asked the Inland Revenue for a system of progressive self regulation. For the reasons above self regulation of the information sent to policy holders was not considered to be a practical option. Leaving the supply of information to a voluntary code would have led to gradual and incomplete improvements over an indefinite period, during which policy holders would, as now, receive different amounts of information about taxable gains depending on which insurer their policy was with. In view of the penalties potentially due for under-declarations of gains from life policies, this would not have been a satisfactory state of affairs going forward.

Regulatory Option

11 In order to implement the changes fully i.e. requiring **all** insurers to tell **each** policy holder both when there has been a gain on a chargeable event and also the amount of the gain, it was necessary to introduce legislation. This will ensure that all insurers offer a service that equates to what is current best industry practice, giving all policy holders who make a gain the same information about their tax affairs. This gives them the information to determine whether the gain has tax consequences and enables them to complete this part of their SA return easily, accurately and on time.

Benefits of the recommendation to change the rules

Benefits to individual policy holders

12 A person who is chargeable to tax on a gain has to report the amount of the gain, the number of years the policy has been held and how much tax is to be treated as paid on the gain. If they receive an SA return to complete, they will include the information in that return. For UK policies, they will normally only have tax to pay on a gain if they are higher rate taxpayers. However a gain may also reduce an individual's entitlement to age related allowances or the child's tax credit depending on the amount of their other income. In those cases the gain must also be disclosed. The measure will ensure that life insurers tell their policy holders the monetary amount of each entry they have to make on the SA return.

13 Not all taxpayers are aware that when they make a withdrawal from a life policy or it comes to an end this may give rise to a liability to income tax. The current system under which it is left to the discretion of insurers what they

tell policy holders may lead to taxpayers unwittingly understating income on their SA return. Even if an individual is aware of the potential liability to income tax when they receive a life insurance pay-out, it is difficult for them to know whether they have made a taxable gain and how much it is if the insurer does not tell them. Currently taxpayers may find it far from easy to work out from their own financial records how much the gain is. The calculation requires details of previous gains and of all payments made to and by the insurer, often over many years. Where the insurer gives them a copy of the information it gives to the Inland Revenue, there is detailed guidance in the SA return Helpsheet about how to calculate the gain. However, even with this guidance available, many taxpayers might not be confident about self assessing the gain without seeking expert assistance, either from the insurer, an accountant or from their local tax office.

14 The new rules will make it easier for the taxpayer to make a correct return and pay the right tax at the right time. It will save the taxpayer time and reduce the need to seek expert help to complete the return. They will also reduce the risk of the taxpayer not paying tax that is due. There is no data available about the amount taxpayers currently pay for professional advice to enable them to make a complete return of their chargeable event gains. It has not therefore been possible to quantify what savings taxpayers will make as a result of receiving better tax information.

15. The parallel changes to the regime for charging part assignments to tax in FA 2001 mean that in cases where there is more than one policy holder, the policy holders do not need to establish whether their beneficial ownership was as joint tenants or as tenants in common. The nature of the legal beneficial ownership would have affected not just the amount of the gain but also who was chargeable. Apart from policies to which Scots law applies, it is likely that in almost every case the joint policy holders would have had to take legal advice to determine the true position had these rules not been changed.

Benefits to Life Insurers

16 Life insurers currently deal with a number of enquiries about tax from their customers. The enquiries concern the amount of the gain and what entries are to be made on the SA return in respect of the gain. When in future insurers send the certificate to the policy holder, telling the policy holder what entries are to be made on the SA return in connection with that gain, enquiries made to the insurer about tax by policy holders who receive SA returns are expected to reduce significantly. Depending on the way that the insurer provides the information, it is possible that the greater volume of certificates reaching policy holders will increase responses from individuals outside the SA population, most of whom will not actually have further tax to pay on the gain. The Inland Revenue will work with insurers on what to tell policy holders so they can work out for themselves whether they have tax to pay. Gains on most UK policies are likely to have an effect on a person's tax liability only if they are liable to pay higher rate tax or are receiving age-related personal allowances or the children's tax credit.

17 It is estimated that the changes will reduce the number of certificates life insurers send to the Inland Revenue by about 90%. However, it may lead to an increase of up to 10% in the communications, including certificates, with policy holders. Only where systems are completely computerised will it be practicable for insurers to send the tax information and cheque to policy holders under the same cover. Electronic payment for all policyholders is likely to be much further away.

18 The changes to the regime for charging part assignments to tax have saved insurers from a position where they would have been required to carry out significant amounts of fact-finding research in order to confirm that they were complying with the statutory rules to provide information. Insurers would have had to

- ensure they knew the property law of which UK country was proper to each insurance contract
- ascertain from policy holders sufficient facts to determine whether, at the time of the assignment, beneficial ownership was held jointly or in common and
- locate all the policy holders and get all parties to agree about the legal position - not always straightforward when according to which legal analysis applies there will be different amounts of tax and different persons chargeable on the gain.

It has not been possible to make an accurate estimate of the hypothetical savings to be made as a result of the changes to the rules for taxing part assignments.

Other issues

19 The one reservation detracting from the benefits above is that the policy holder is not always the person who has to put the gain on their SA return. For example, an UK resident is chargeable to tax on any gains from an insurance policy held by the trustees of a trust of which he or she is the settlor. The policy holder is however the only person known to the insurer as having an interest in a particular policy and is the person the insurer currently notifies to the Inland Revenue in connection with a gain from a particular policy. The policy holder would normally know the identity of the person chargeable to tax on the gain if they themselves were not chargeable. The person who has to include the gain on their SA return is reliant on the policy holder to pass on the information from the insurer about tax and the new rules do not alter this. To require the insurer to find out who is the chargeable person would impose a new and significant regulatory burden for insurers and for this reason is not part of this measure.

Impact on older people

20 Older people will benefit from the insurer telling them exactly what entries they need to make in their SA return when they make a gain from a life insurance policy. It will make it easier for the elderly to complete their SA return correctly and so reduce the need for them to seek expert help.

Compliance costs

Business Compliance costs

21 There are just under 350 companies and friendly societies operating in the UK that are authorised to sell life insurance. It is estimated that about 300 of these sell insurance products that give rise to chargeable event gains. These life insurers are already required to have systems to recognise when a chargeable event certificate for the Inland Revenue is required and to collate the information needed to complete and issue the certificate. The large majority of these systems are a combination of computerised and manual processes. A small proportion is totally computerised and approximately one fifth (about 60 businesses) are completely manual. The assumption is that it is mainly the smaller insurance companies and Friendly Societies who have entirely manual systems.

22 The Finance Act measures will require a number of changes to the internal systems of the life insurers:

- to calculate the chargeable event gain (one-off and recurrent costs)
- to make more than one calculation of the gain in a policy year and issue a certificate for each calculation where there is a part assignment and part surrenders in the same policy year, (one-off and recurrent costs)
- to identify which of the policy holders should receive the certificate when there is a part assignment and a part surrender in the same policy year (one-off costs for systems changes)
- to present information to the Inland Revenue in a newly prescribed form (one-off systems costs)

23 Some insurers (the precise number is not known) already calculate the gain for their policy holders. They would not therefore have to make significant changes to their systems to comply with the first of the four bullets above. Those who do not currently offer this service will however need to make internal system changes.

24 The range of one-off costs that insurers with computerised or mainly computerised systems are going to have to incur on making these changes is estimated to be between £50,000 for those who already compute the gain for policy holders to £100,000 for insurers who do not. This includes training costs. The assumption is that the one-off costs of changing the systems for companies will be lower for companies with significant manual intervention and lower still for companies with fully manual systems. However, the companies with manual systems might be expected to have greater ongoing costs for training and operation of the new rules going forward. The Inland Revenue has released informal guidance via the ABI and ILAG to insurers so that they can begin training staff. No companies with significant manual intervention or fully manual systems have provided cost estimates in response to the publication of the draft RIA on Budget day.

25 There is one category of insurer whose one-off costs will be greater than the amounts above. The lack of a lower limit for reporting gains to policyholders will particularly affect the few companies engaged in selling insurance door to door, known as industrial assurance business. Previously they did not have to report gains to the Inland Revenue if the total benefits paid were less than £500. It is estimated that the total one-off costs to be incurred by the 5 – 10 companies operating in the industrial assurance sector will be in a range of £1.65m - £2.55m.

26 The overall estimated costs to the industry of implementing this measure are based on the assumption that

- the 100 largest life insurers have computerised or mainly computerised systems,
- the 125 middle companies have systems with significant manual intervention and
- the 75 smallest operators have mainly or wholly manual systems.

27 Life insurers have estimated that their one-off costs will be between £50,000 and £100,000. The cost estimates use a sliding scale for the rest of the companies depending on size. The one-off costs for industry outside the industrial assurance sector are therefore estimated to be

- 100 largest insurers £5m - £10m
- 125 middle-sized insurers £20,000 - £30,000 each or £2.5m - £3.75m
- 75 smallest insurers £10,000 - £20,000 or £750,000 - £1.5m
- Industrial assurance sector £1.65 – £2.55m.

28 Since insurers provided calculations of their costs, the Inland Revenue has decided that it will take responsibility for producing and distributing blank certificates. This reduces the overall costs insurers are expected to incur by at least £1million. Taking this change into account, the final figure for one-off costs expected to be imposed on business implementing this measure up to April 2002 therefore fall in a range of £8.9m - £16.8m.

29 For companies with mainly computerised systems the ongoing costs are not expected to be materially greater than they were before the changes take effect. The ongoing costs for the 200 or so companies with significant manual intervention in their systems for producing certificates are estimated to be in a range of £1.5m – 2m a year, being the cost of extra staff time spent on calculating the amount of the chargeable event gain (approximately £7,500 - £10,000 a year per company). The additional costs for the small number of companies selling and administering industrial assurance business who will need to issue about 15,000 – 20,000 more certificates a year are expected to be £225,000 - £400,000 a year. That is based on an average cost of £15 - £20 for producing each additional certificate.

30 The recurring costs for operating the new system therefore fall into a range of £1.725m - £2.4m a year.

31 In the context of the additional costs insurers will have to bear in order to operate the new reporting systems, paragraph 3.6 from the submission that the ABI made to the Finance Bill Standing Committee is worthy of inclusion here:

“The ABI fully supports the principle underlying this change, which is to ensure that wherever possible policyholders have the information they need to deal with their tax affairs. This is despite the fact that insurers will incur material costs, in some cases likely to run to hundreds of thousands of pounds, in adapting administrative and computer systems and staff procedures in order to perform this task for the benefit of their customers.”

32 The amendments will not involve insurers in collecting any additional data (although it may involve them keeping information about past policy holders on their systems longer than they have been used to doing), nor will there be any tax planning compliance costs or additional movements of money to consider.

33 In response to submissions made by the representative bodies for the industry (see at end of the RIA) the Government has decided to delay for twelve months until 6 April 2003 the requirement for insurers who opt to tell the Inland Revenue about all gains to do so using electronic media. This will allow insurers to spread the work effecting systems changes over a longer period. This will ease the pressures on insurers making systems changes and may reduce the one-off costs to some extent as they are able to make the most efficient use of their IT resources.

Inland Revenue Costs

34 There is unlikely to be any major impact for the Inland Revenue's ongoing administration costs in the network or in the Taxes Information Distribution Office (TIDO). Under the SA regime local tax offices do not calculate chargeable event gains for the taxpayer as a matter of course, although they may do so occasionally when asked to do so by the taxpayer or when making an enquiry into a return. In practice, cases where the tax office currently uses the information on the certificate to calculate the gain is an extremely small proportion of all the gains made and returned. There will be a saving of about four staff units in TIDO as a result of the reduction in the number of certificates submitted by insurers all of which should be capable of being sorted electronically with optical character recognition technology if delivered on paper.

35 There will be a costs of around £1million to £1.25 million in the first year for the design, production and distribution of the certificates in the prescribed form for insurers to send to the Inland Revenue. This will reduce going forward as more insurers begin to use electronic media instead of paper to deliver the information and the threshold to reduce paper certificates submitted takes effect.

Securing Compliance

36 Full implementation of the changes (subject to paragraph 33 above) is not planned to take effect until 6 April 2002. This will give the Inland Revenue time to distribute guidance for insurers about calculating the amount of the gain well in advance of implementation. It will also give insurers the time they need to implement the systems changes required and train their staff appropriately.

37 There are no changes anticipated to the current compliance regime. The Inland Revenue currently has the power to inspect the records of insurers in order to verify both whether insurers are issuing certificates to the Inland Revenue when they are required to do so and whether they contain complete and accurate information. Once insurers are required to send certificates to their policy holders, Inland Revenue auditors will retain the power to verify the certificates issued by insurers both to the policy holder and to the Inland Revenue. The inspector will be able to take proceedings for penalties against the insurer in respect of each certificate that the insurer fails to send or sends late or completes incorrectly, whether required to be sent to the policy holder or the Inland Revenue. The costs for insurers being audited should not be materially different from what they are under the existing rules.

Impact on Small Business

38 The 300 or so UK -based companies and Friendly Societies who are likely to be affected by this measure are not generally regarded as "small" businesses.

Consultation

39 Three insurance industry representative bodies made detailed representations about the partial RIA published on Budget day. The information and submissions they made is reflected to a significant extent in this finalised RIA.

40 The three representative bodies are:

- the Association of British Insurers, whose members include a large majority of all life insurance companies in the UK
- the Association of Friendly Societies, whose members include most Friendly Societies in the UK
- the Investment and Life Assurance Group, which has a membership of around 40 including life insurance companies, friendly societies and unit trust managers.

Monitoring and Evaluation

41. The impact of this measure will be monitored and reviewed as considered appropriate.

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