Keeping Up with Tax for Insurance

October 2019

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Introduction

Welcome to our October edition of Keeping Up with Tax for Insurance, and what could be our last edition with the UK as a member of the European Union (although we have said that before!).

Whilst politics and Brexit continue to dominate the news agenda, there are also ongoing developments on the tax front which insurers will need to monitor. These include progress internationally, such as the ongoing OECD work on reforms to the international tax system, and domestically, including the new guidance on CCO and the upcoming budget. We have provided summaries on a number of these areas, that are of broad interest and relevance to insurance groups.

As well as keeping on top of the ever changing tax agenda, a number of our team attended and participated in the annual ABI tax conference in Brighton. I was part of the “Big 4” panel closing the convention, discussing the challenges and opportunities facing our industry (and answering many awkward questions kindly placed by the audience!). It was great to see so many familiar faces there, and some new ones, and I really enjoyed the occasion.

There were a number of really insightful sessions over the conference, for example on developments in tax technology across the industry (we may all be getting replaced with robots soon!) and the future of the workforce. We are planning future articles on both of these evolving topics, but in the meantime, for those who were not there, it’s worth reviewing the slides from the day.

We’ve prepared the following articles this month, to bring you all up to date with ongoing developments :

- OECD and Digitalisation - What does this mean for Insurers
- Digital Services Tax - application to FS groups
- Environmental, Social and Governance – the growth of sustainable investing
- Capital loss restriction - Updated legislation
- Corporate Criminal Offence - 2 years on

I hope you enjoy the articles that we have put together, and as always please get in touch with me or your PwC team if there is anything that you would like to discuss further.

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OECD and Digitalisation

What does this mean for Insurers

Background

In our July edition we discussed the G20/OECD work plan around the digital economy and the significant changes to the international tax framework that are expected as a result. The momentum behind these proposals has been building with increasing changes to the political environment bringing this into focus on the global agenda. These proposals are likely to change the international tax landscape in a fundamental way.

Increasingly, countries are attempting to respond to the challenges of digitalisation. More than 20 countries have brought in a version of a Digital Services Tax ("DST"). The newly proposed French tax resulted in a Trump twitter response (and retaliatory wine tax suggestion) which was reportedly quelled with a compromise struck between the sides which foresees France repaying companies the difference between the French tax and the tax that would be suffered under the OECD's proposals. Other countries have also said that a version of both Pillar One and Pillar Two of the original proposals needs to be implemented (previously it had been discussed whether one of the two would be sufficient). We've summarised these two pillars below.

On Wednesday 9 October, the OECD released a public consultation document setting out their Proposal for a "Unified Approach" under Pillar One and inviting written comment. The public consultation meeting will be held on 21 and 22 November and it is expected that it will be definitive in the development of a solution for the OECD's final report to the G20 in 2020. Likewise, the OECD are scheduled to deliver a progress report on Pillar Two towards the end of 2019 which will seek to agree the principles of the proposed changes. We expect intensive discussions between the OECD, Member states and other stakeholders to continue, and to reach an agreement on the full detailed framework for both Pillars in 2020.

This article seeks to provide a brief overview of the OECD's proposals, covering where the conversation is at now and highlighting the potential impact of these proposals on the Insurance Industry. However let us warn you that it has taken us a few pages to do that… (but hopefully it is still worth your time!) We have also produced an article discussing the financial reporting considerations which you can read here.

Pillar One - Profit allocation and Nexus Rules

The objective of Pillar One is to tax the value derived by a business' activity or participation in user/market jurisdictions that is not recognised in the current transfer pricing rules. In an increasingly globalised world it is possible for multinational companies to access customers (and in our industry, insure risks) remotely or with limited presence, effectively increasing the company's value as a result, yet not be subject to tax in the jurisdiction from which this value was derived. Pillar One thus considers the design of a new rule that would capture the modern concept of business presence in a jurisdiction without physical presence, the different approaches to determining the amount of profits subject to these new taxing rules, and how to eliminate potential double taxation of these profits.

The OECD Programme of Work, released in March 2019, outlined three proposals under Pillar One, namely: user participation, marketing intangibles and significant economic presence. In the consultation document released this month, the OECD put forward a new approach based on the commonalities between these proposals, considering the ultimate aim of Pillar One, the views expressed during consultations, as well as the need to deliver a simple and feasible solution.

The proposal for a "Unified Approach" would modify the current treaty and transfer pricing rules and introduces a new taxing right for market territories (a "nexus" under these rules) which is largely based on sales. Specifically, the proposals seek to remunerate the market territory for a portion of the residual profits remaining after all consolidated costs have been stripped out, and a reasonable profit has been allocated to "routine" activities, leaving the "excess" profits. A portion of these deemed residual profits will be reallocated to jurisdictions based on the current transfer pricing rules (i.e. on current value drivers) but the remainder will now be used to remunerate the market jurisdictions from which the business derives its value.

The new proposal recognises that further discussion is needed on whether certain sectors should be carved out, acknowledging that some countries have proposed an exemption for some financial services activities.

OECD and Digitalisation (cont.)

What does this mean for Insurers

While the approach is described as unified, the process of reaching consensus remains in an early stage, and many key elements require further work. In particular, defining with specificity the rates of return deemed to be "routine" and "excess" remain significant policy decisions. Additionally, the threshold to be applied for a territory to have a taxing right under these rules will need to be carefully defined (which may for example be on volume of revenue as for CbCR requirements) and the degree of local flexibility will need to be agreed in order to develop an appropriate new treaty article. Finally, how the proposals could be legally implemented (including dispute resolution mechanisms) will be a critical workstream in these discussions (as this is clearly essential in mitigating double taxation).

Impact for Insurers

The proposition is still in its early stages and there remains a lot of uncertainty around the detail. However the most likely impact for Insurers, given the overarching aims of the Pillar, will be on the operating models for multinational business. Examples of area impacted may include:

- *Cross border Insurance sales*

Under European principles/passporting rights, an insurer has the ability to write a contract of Insurance in Frankfurt while the risk is located in Paris, without creating a taxable presence in France. The Pillar 1 proposals may result in an amount of tax being payable in France in our example.

- *Reinsurance (Business to Business)*

The proposals may require reinsurers to start considering who their customers are and where they are based (potentially where the risk they are reinsuring is located). The proposals could result in a company reinsuring a book of South African risk paying tax on a proportion of profits allocated to South Africa. As discussed in the Industry considerations section below, there are currently discussions around how this Pillar would be practically implemented and whether certain exemptions, such as business to business sales (which reinsurance may fall under), would be needed and if these are within the policy's intentions.

- *Brokers/Local Fronters/Coverholders*

Use of local brokers/fronters/coverholders to access specific markets are common in the insurance sector. However under the new proposals, access to a market, even if through a third party intermediary, may lead to tax being payable in the market. For example, if a London market insurer were to access customers in Singapore through a local fronter, a portion of the profits from this business may need to be taxed in Singapore (even where the insurance risks all remain in the UK).

- *Multinational contracts*

Under the proposals, groups may need to look through single contracts to the markets that are covered by the insurance policy, as each territory covered may have to be appropriately remunerated for the benefit they receive under the Insurance contract.

In addition to the impact of the rules themselves, there is also the possibility that paying tax in jurisdictions where you do not currently have taxable presence may well lead to increased scrutiny and debate about whether you should be recognising a Permanent Establishment in that jurisdiction. This may have implications for other taxes as well as broader commercial implications.

Industry Considerations

Within Pillar One, one of the crucial discussion points is the role of reinsurance and how these rules may practically apply to business to business sales. Specific concerns are the scope of Pillar One and the challenges that would exist around identification and measurement issues for reinsurers (how would routine and non routine profits be identified).

Insurance is a highly regulated business and so it is often difficult to carry out without a physical presence (that would be remunerated under the current transfer pricing rules). As the industry is commonly required, from a regulatory perspective, to have a physical presence where it has customers then from a policy angle does it make sense to subject the industry to this administrative and compliance burden, or would it make more sense to exclude it from the scope?

Additionally the Insurance market can be highly volatile with the potential of large, shock losses being suffered in some years that may be carried forward and utilised for many years. Under the current proposals it is not clear how these losses may be treated; would they be allocated under the same methodology as profits or would another allocation be applied?

OECD and Digitalisation (cont.)

What does this mean for Insurers

The Pillar One proposals are still under discussion, however, in the early drafts of the proposition there were discussions around potential carve outs for certain financial services and other activities. Many countries are lobbying for the interests of certain sectors/industries. Whether a carve out from the rules should apply for insurance is therefore an open question, though it is encouraging that specific references were made to financial services in the recent OECD document. Similarly, we note that business to business transactions do not appear to fit within the policy objectives of tackling customer based marketing intangibles unless it is carefully and precisely framed.

At a practical level this Pillar is likely to increase the compliance burden for all international businesses who will need to ensure their systems are capable of recording more detailed information of all sales made, including who they are selling to and where the ultimate benefit of the services is located. It is possible that a de-minimis level (such as for CbCR) will be introduced to help with the compliance burden.

Pillar Two - Global anti-base erosion proposal

Pillar Two seeks to address the remaining risk of profit shifting to territories with no to very low taxation, that were not perceived to have been fully addressed by the BEPS project. This Pillar intends to do that by implementing a set of common rules to ensure minimum levels of tax are applied to all income. The proposals suggests that this could be done through the development of two inter-related rules; income inclusion rules and tax on base-eroding payments.

An income inclusion rule would seek to tax a branch or controlled foreign company at a minimum rate if the income it currently receives is taxed at below an effective minimum rate. This rule is designed to supplement (not replace) the existing CFC rules and may be practically implemented by switching off foreign branch or entity exemptions in cases where minimum profits are not met. The income inclusion rule draws on aspects from the recently introduced US regime for taxing Global Intangible Low-taxed Income ("GILTI").

The way the income inclusion concept is expected to operate means it is not a catch all rule. For example, in scenarios where the group is headquartered in a low tax jurisdiction (such as Bermuda) and that country did not introduce these rules, an income inclusion rule may not be effective. Therefore an alternative rule is also being considered. The base-eroding payment rules could operate in two ways:

A denial of a deduction for certain payments (largely those to related parties), unless the payments would be subject to tax above a minimum rate. This could include for example, reinsurance payments made from the UK to Bermuda. Under the proposals, a restriction would be placed on the deduction taken in the UK on the reinsurance payment forcing the group's effective tax rate ("ETR") up.

Restrict the access to treaty benefits if the group meets the minimum taxation levels. This could result in withholding taxes being due on these payments, and in this scenario we may also see domestic law apply withholding taxes to more payments made.

Impact for Insurers

First and foremost this Pillar is likely to create winners and losers. Groups headquartered in higher tax-paying jurisdictions are likely to experience a comparably smaller impact from this Pillar than groups headquartered in low tax jurisdictions such as the Cayman Islands and Bermuda.

Groups that have a significant proportion of their profits taxed in jurisdictions with low tax rates are likely to experience an increase in their effective tax rate (and cash tax suffered). If the international tax system moves towards a minimum standard of tax, it may have a wider-reaching impact of prompting groups to conduct a cost-benefit analysis of the regulatory or capital benefits offered by lower tax rate jurisdictions.

A number of details under this proposal need to be carefully considered, as their definition may fundamentally alter how the taxation of this Pillar works. Under the income inclusion rules it is unclear whether the minimum tax would be calculated on a group or entity level. Additionally, there are challenges around how the new rules would interact with countries existing rules (e.g. would the UK CFC rules be redundant or would they still be used). Furthermore, with the implementation of US tax reform last year an increasing number of financial services companies have made elections to opt to tax non-US tax resident companies as if they were US tax resident. From a UK tax perspective, these companies are still viewed as being tax resident in the local country; it is not clear how this type of election would interact with the proposals under Pillar Two.

OECD and Digitalisation (cont.)

What does this mean for Insurers

In addition, we are likely to see changes to treaties and domestic laws to ensure rules do not result in double taxation and so that it is clear which country has the right to tax those profits.

Industry Challenges

A key element for this Pillar is the avoidance of double taxation. This may arise because of multiple inclusion rules creating duplication of taxing rights or because of the complexities of the denial of deduction rules (e.g. BEAT) creating multiple deductions.

As a result of this heightened risk of double taxation a key challenge will be dispute resolution. The mechanism behind international dispute resolution will have to become more efficient to reflect the anticipated increase in demand and should be addressed within the work of the OECD.

Additionally, there is a debate around whether a global approach to the calculation (like the US GILTI rules) or a territorial approach (like most existing CFC rules) would be preferable. This debate is even more important for insurers in the context of how losses carried forward may be included and the implication that they would be more likely to be included in a territorial aggregation but that this is unlikely to be possible in a global aggregation.

What should companies be doing now?

These proposals are extensive and far reaching and will fundamentally change the international tax landscape. They are attempting to create a global tax system that is fit for purpose in a modern, digitalised and increasingly multinational economy.

The impact of these proposals are likely to affect all businesses. The OECD consultation for Pillar One has opened, as mentioned above, and the OECD are expected to issue a progress report on Pillar Two towards the end of 2019. There remains a number of fundamental policy decisions/recommendations that need to be decided, and is it still possible to discuss with the OECD and individual country delegates to ensure industry viewpoints are considered during policy drafting.

It is important that the magnitude of these changes are evaluated and communicated to key stakeholders early, highlighting the potential commercial impact on the business, future implications on ETR, as well as compliance and system requirements and obligations that may be impacted by the drafting of Pillar One and Pillar Two.

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Digital Services Tax – application to Financial Services groups

As discussed in previous editions, the UK proposes to introduce a Digital Services Tax ('DST') from 1 April 2020. This new tax is a unilateral measure introduced by the UK in response to the perceived under-collection of taxes from digital businesses, with similar measures adopted by other countries such as France and the Czech Republic, and being discussed at EU level. The UK government has confirmed that they intend to replace this tax in the event of an international agreement on reforms to the international tax system (see previous article). However, given the proposed timescales for the new OECD measures, we expect the UK DST to be in effect for some time.

Legislation for the UK's DST was included in the draft 2019-20 Finance Bill published on 11 July 2019. The broad outline of these rules is that UK digital services revenues arising in a period are taxed at 2% (less a £25m allowance) from 1 April 2020. UK digital services revenues are revenues of search engines, social media platforms and online marketplaces which derive value from UK users. This is subject to a threshold test that £500m of global revenues must be generated from relevant activities of which £25m relates to the UK.

These rules include a proposed exclusion for 'Online Financial Marketplaces', which is in line with our understanding of the intentions of the Treasury to exempt Financial Services to these rules. However, no guidance has been issued in relation to this exemption.

As a brief summary, an 'Online Financial Marketplace' is excluded from these rules, if:

- It is provided by a **financial services provider**; **and**
- More than half of the relevant revenues arise in connection with the provider's facilitation of the trading or creation of **financial assets**.

Concerns with the currently drafted exclusion for 'Online Financial Marketplaces'

The current drafting of the 'Online Financial Marketplace' exclusion leaves uncertainty as to how the exclusion should work in practice and does not exempt certain financial services activity. Examples of this include:

- Whilst the definition of 'financial services provider' is broad, it does not include 'Exempt Persons' (such as appointed representatives).
- The DST is levied at **group level** and then the liability for payment is allocated between entities, but the exemption applies to **individual companies** at an activity level. This incongruity gives uncertainty as to how it should be applied, in particular where an affiliate of the provider is regulated, but the provider itself is not.
- There are certain products which are not or may not always be 'financial assets'. These include, but are not limited to, certain derivative contracts which may be held by insurers and crypto-assets (including cryptocurrencies). Careful review will be required as to the activities carried out by insurance groups to confirm these all fall within these exemptions.
- Regulated persons trading on unregulated platforms and these unregulated platforms themselves could also fall outside the financial services exemption as currently drafted. An example is online bulletin boards, which 'facilitate the sale by users of particular things' but are not required to be authorised persons or a recognised investment exchange since they do not support the execution of transactions.
- There is a risk that platforms such as comparison sites could potentially operate outside of the perimeter and therefore within the scope of the DST.
- There may also be some services which are not covered by the 'financial services provider' exemption because the relevant services are not currently considered regulated activities in the UK. For instance, operating a payment application on a mobile phone might not currently constitute a 'payment service' for the purposes of the regulatory perimeter but could come within the broad definition of 'online marketplace' in the DST rules.
- Where the business is not UK resident there is a challenge to compare the UK and non-UK activities to determine if they can be considered equivalent.

Digital Services Tax – application to Financial Services groups (cont.)

Next steps for Insurers

Whilst the 'Online Financial Marketplace' exemption from the DST is welcome, additional updates and clarifications are needed to ensure this operates as intended. The Treasury closed a consultation into these rules in early September. Following this, it is hoped that legislative and guidance updates will be made in relation to the issues raised above.

The intention of this law is as an interim measure until multilateral reform is introduced. In June 2019 the OECD approved a work plan for 2019/20 with the intention for a consensus solution to be agreed by December 2020 in relation to these matters. Therefore, whilst the DST is intended to be an interim measure it is likely to apply until 2021 or maybe beyond.

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Environmental, Social and Governance
The growth of sustainable investing

Context

With one million species facing extinction, an estimated 40 million victims of modern slavery and the world on track to warm between 3C and 5C above pre-industrial levels by 2100, environmental and social considerations are beginning to impact investment decisions across all timescales.

Sustainable investing takes into account risk factors that could arise from issues such as environmental change, increasing social inequality and poor governance. These risks are considered beyond the usual three to five year business cycle, to screen and mitigate for risks that could manifest in the medium to long term. Sustainable investing could also help investors capitalise on opportunities that contribute to a more sustainable economy. Research has consistently found that companies with high Environmental, Social and Governance ('ESG') ratings outperform those with lower ratings. A University of Oxford meta-analysis on ESG performance found that in 88% of studies, companies with robust sustainability practices had better operational performance, and 80% of studies found that good sustainability practices had a positive impact on investment performance.

Around 2,000 asset managers and investment managers have signed up to the UN Principles of Responsible Investment, and over a quarter of global assets under management are now invested according to ESG principles.

While sustainable investing is becoming mainstream, it is not yet universal amongst asset and wealth managers. For example, PwC's Private Equity Responsible Investment Survey 2019 found that only 35% of respondents had dedicated responsible investment teams (although this has grown since 2016).

This article considers three key reasons why asset owners should step up their consideration of ESG factors: changes in the regulatory environment, a shift in investor attitudes and developments in technology.

Regulatory environment

The disclosure and consideration of ESG risks and performance is hardening from a voluntary practice to a mandatory requirement.

This is exemplified by the Task Force on Climate-related Financial Disclosures ('TCFD'). The TCFD developed a voluntary framework for climate risk disclosures but its adoption by firms is increasingly being encouraged by regulators. For example, the UK Prudential Regulatory Authority now expects banks and insurers to consider engaging with the TCFD framework. Additionally, the UK Government, as part of its Green Finance Strategy published early in July, announced that it expects all listed companies and large asset owners to disclose in line with the TCFD recommendations by 2022.

This year has also seen several major pieces of regulation come into effect, including the EU Shareholder Rights Directive II and new requirements for trustees of UK pension schemes to set out their ESG and stewardship policies. The introduction of new regulations concerning sustainable investment shows no sign of slowing down in the future, A wide regulatory agenda, arising from the EU Sustainable Finance Action Plan and the UK Green Finance Strategy, is being introduced over the next few years with implications for asset owners and managers.

Environmental, Social and Governance (cont.)

The growth of sustainable investing

Investor appetite

The consideration of ESG factors in investment decisions is being pushed by a raft of EU and UK legislation but it is also being pulled by investor demand. This is largely driven by younger consumers who want to invest with purpose and are significantly more likely to see the social responsibility of their investments as an important selection criterion than previous generations. Sustainable investing is already having a profound impact on the market, as evidenced by the huge popularity of green bonds which have emerged from nowhere to become a multi-billion dollar market over the past few years, with $521bn green bonds being issued since 2007. With intergenerational transfer of wealth predicted to be $30 trillion over the next two decades, it is essential that asset managers recognise this impending shift in investor sentiment is going to revolutionise the market.

The shift in consumer sentiment towards sustainable investing presents an opportunity for asset managers but also threatens those who fall behind. Organisations that are perceived to invest in an unsustainable way are subject to greater scrutiny by the media and non-profit groups. Groups such as ClientEarth and ShareAction are already assessing how institutional investors such as pension schemes manage climate risk, and have warned that trustees face legal challenges if they fail to develop their approaches.

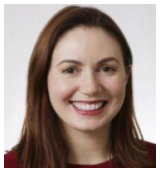
Technology

Historically, a lack of standardised, high quality data has delayed the advance of sustainable investing. However, as the amount of ESG information disclosed by companies under voluntary standards and mandatory regulation is rapidly increasing, data processing rather than data availability might soon become the pinch point. The vast quantity of information is surpassing human capacity to sift through it and distinguish investment signals from the noise. This is where new technologies come in. The integration of AI, machine learning and robotic process automation will improve efficiencies in ESG screening, and could save financial professionals 46% of their time in gathering research and information. This type of big data analysis could quickly become the future of investing.

New technology could also enhance the quality and reliability of ESG information. Blockchain is being assessed as a tool to enhance ESG risk management, supply chain transparency and data protection.

New steps for Insurers

To respond effectively to these disrupting forces, they will have to do more than simply spot future risks and opportunities. They will need to keep an eye on the regulatory horizon as scrutiny becomes more stringent, and create agile and responsive business models that can adapt to the evolving ESG landscape. A good understanding of their investor base is also a crucial requirement, especially in light of the ongoing wealth transfer to the highly socially and environmentally aware of millennial generation.



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Capital loss restriction for Corporation Tax

As discussed in previous editions, HMRC have been consulting on introducing a new restriction on the offset of capital losses, broadly mirroring the changes introduced in 2017 for other tax losses. PwC was one of the respondents to this consultation. Click here for a link to the summary of the consultation and HMRC's responses to the comments raised by respondents. This consultation has now concluded and HMRC issued draft legislation for these new rules in July, with the rules expected to come into force in April 2020.

Subject to certain amendments from the consultation process, HMRC have confirmed that the rules will be coming into force as intended from next April. Importantly, for the life insurance sector, HMRC have revised the previous proposals to apply this restriction to shareholder gains within the Basic Life Assurance and General Annuity Business ('BLAGAB') I-E tax computation. The new rules should generally ensure the restriction does not apply where historic BLAGAB losses are offset against BLAGAB gains.

Specific Points addressed by HMRC in the final rules

Aside from certain specific points outlined below, the draft legislation is in line with previous expectations given the policy intentions set out by HMRC. In summary, the new capital loss restriction will be an extension of the existing corporate income loss restriction. From 1 April 2020 a company with chargeable gains will potentially no longer be able to utilise any unused capital losses brought forward in full. The current £5m limit in respect of the corporate income loss restriction rules ('the Deduction Allowance') will be shared with the capital gain loss restriction. Any capital losses to be utilised over and above this £5m limit in a given accounting period will be restricted to 50%.

One of the key discussions during the consultation process was around the treatment of capital losses offset against BLAGAB chargeable gains in life insurance groups. HMRC have withdrawn their previous proposal to apply these rules to the shareholder share of these gains and the updated legislation aims to ensure that there will be no restriction on the offset of BLAGAB losses against BLAGAB gains. There are detailed rules within these measures where capital losses 'cross the BLAGAB ring fence'. Life insurance groups should assess the impact of these measures where they may be relevant.

HMRC have also stated that they will provide an update as to how these rules will affect companies in distress or insolvent, although no time frame has been given for providing such an update.

A number of concerns were raised by respondents that the rules adversely impact certain sectors which should have specific exemptions, such as medical research companies which often accumulate substantial losses prior to making substantial profits. HMRC have indicated that they will not propose any specific exemptions apart from those that have already been laid out in respect of the oil and gas sector.

Due to the existing restrictions on disposals to connected parties a number of respondents to the consultation suggested that an additional restriction would be excessive. HMRC agreed with this and have amended the legislation to allow companies to use carried forward connected party losses in place of capital losses for a given accounting period where this is applicable in a given accounting period.

Real Estate Investment Trusts ('REITs') are subject to a tax regime whereby they are typically exempt from tax on their chargeable gains and as such these new capital loss restriction rules will not be applicable for capital losses that are associated with Property Income Distributions ('PIDs').

In instances where a company has a one day accounting period, by virtue of making a disposal that is subject to capital gains tax but where the company is not otherwise chargeable to Corporation Tax, then the full amount of the £5m allowance will be available. It was highlighted that the original legislation would indicate that 1/365 of the £5m allowance would be available. HMRC have confirmed that such companies with a one day accounting period will be able to access the full £5m deduction allowance per financial year. HMRC have also indicated that they will introduce rules that will allow companies with multiple one day accounting periods in a financial year to offset capital losses against capital losses which arise in that year.

Where capital assets which are used as a hedge are disposed of, if this disposal does not take place at the same time as the asset which it is hedging, there is a potential that such gains or losses may occur in different accounting periods and may accordingly be impacted by these rules. HMRC have noted in their responses to the consultation that they will not include a specific provision to mitigate the impact of these capital loss restriction rules in such a situation, so insurance groups should take care around the timing of such transactions if this may create a significant tax mismatch.

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Corporate Criminal Offence

Introduction

The Corporate Criminal Offences for failure to prevent the criminal facilitation of tax evasion ('CCO') were introduced on 30 September 2017 as part of the Criminal Finance Act 2017. The primary aim of the legislation is to hold relevant bodies, companies or partnerships, criminally liable where they fail to prevent those who act for, or on their behalf, from criminally facilitating tax evasion. The new offences were introduced to address perceived difficulties in attributing criminal liability to relevant bodies for the criminal acts of their employees, agents or those that provide services for or on their behalf.

The only defence organisations will be able to rely on is to demonstrate that they have reasonable prevention procedures in place to prevent the facilitation of tax evasion. The key first step in demonstrating reasonable prevention procedures are in place is to carry out a risk assessment to evidence how you have considered the risks of facilitating tax evasion across your business, the mitigating controls that are in place and what additional actions need to be taken.

Two years in – What is the current status?

Many financial institutions have undertaken a risk assessment based on assessing the inherent risk of different areas of their business, applying structured risk assessment methodologies to identify and rate risks, then reviewed existing controls in order to assess residual risk. Residual risk assessments have informed implementation plans to modify/introduce controls, update training programmes and issue communications from senior management, to demonstrate that reasonable prevention procedures are in place. In initially addressing CCO compliance, some common challenges and pitfalls encountered included:

- **Assuming legislation impacts UK operations only –** Failure to understand the extraterritorial nature of the offence as well as the UK nexus issue in respect of the overseas offence.
- **Assuming regulated entities don't face any risk –** Assuming that because an entity is regulated that this protects it from CCO risk and related prosecution.
- **Considering existing financial crime controls without a tax evasion facilitation lens –** Focus on existing financial crime processes (such as AML and Anti-Bribery & Corruption) without giving explicit thought to the risk of tax evasion facilitation and if current controls mitigate that risk.
- **Focus on facilitation of tax evasion by clients only** – Focusing only on the risk of facilitation of client tax evasion at the expense of consideration of wider tax evasion facilitation risks. e.g. supply chain, HR/Payroll processes and Finance processes.
- **Focus on tax evasion rather than tax evasion facilitation –** Focusing on the risk of underlying tax evasion rather than the risk of facilitation of that evasion.
- **Believing a low risk profile precludes the need for a risk assessment –** Contrary to HMRC's view certain organisations didn't carry out a risk assessment as they felt they were low risk to begin with.

Why CCO remains relevant requiring continued focus

CCO should remain a key area of focus as it represents a key aspect of the international cooperation between HMRC and international tax and regulatory bodies in tackling tax evasion and the facilitation thereof. In addition the potential impacts of getting it wrong are serious, including; corporate criminal convictions, unlimited penalties, reputational damage and regulatory censure. Other considerations include:

- **HMRC have started criminal investigations –** A number of criminal investigations with potential CCO implications have been started by HMRC. In addition, HMRC has recently written to many large businesses reminding them of their obligations in respect of the CCO rules.
- **Enhanced HMRC Business Risk Review** – HMRC's updated BRR process will focus on businesses compliance with CCO legislation.
- **Senior Manager and Certification Regime –** A key area of the regime's prescribed responsibilities focus on ensuring firms are not used for the furtherance of financial crime and hence overlap with CCO.
- **Increased international coordination amongst authorities –** Tax and financial crime agencies in the UK, US, Canada, Netherlands and Australia have established a new alliance (Joint Chiefs of Global Compliance ('J5 Alliance')) dedicated to increased collaboration on tackling international tax crime and money laundering.

Corporate Criminal Offence (cont.)

Next steps – What should be the focus going forward

If you are starting out on your journey

For those organisations who are still at the early part of or starting on their compliance journey in respect of CCO there are a number of key areas or 'quick wins' that should be the initial areas of focus. These include:

1. **High level risk assessment –** Based on a consideration of products/services offered, nature of clients and where they are based and how those clients are serviced identify where key risks may be faced and what actions are required to address them.
2. **Senior Management Communication –** Ensure that a clear message is cascaded across the organisation making clear that there is 'Zero Tolerance' for tax evasion and the facilitation thereof.
3. **Training** – Leveraging existing organisational arrangements ensuring staff receive appropriate levels of training given their roles and potential CCO risk faced.
4. **Associated Persons –** Identify potential population of Associated Persons with a view to identifying which may pose a higher risk level in respect of CCO and addressing those risks accordingly.

If you are well down the path to implementation

If you are well down the road to implementing your approach, you should be focusing on validating the approach that you have taken and gaining assurance that your 'reasonable assurance procedures' are in place and operating effectively through focusing on the following:ely.

- Assessing the robustness of the risk assessment methodology applied, adequacy of risk factors considered, completeness of approach and conclusions reached;
- Reviewing the completeness of 'reasonable prevention procedures' being put in place;
- Evaluating the monitoring and review activities that have been defined.

Key areas of focus in these activities should include:

1. **Review of risk assessment methodology –** What coverage model was applied (UK/Global), what risk factors considered, what scoring mechanism applied and which Associated Persons were considered. How were inherent and residual risks assessed and what level of review and challenge were applied to the results.
2. **Risk factors considered** – Ensure an appropriate set of risk factors were considered e.g. country risks, product risks, sectoral risks, transaction risks, business partnership risks and any customer risks.
3. **Completeness of approach –** Evaluate the approach taken avoiding common mistakes in CCO reviews highlighted earlier.
4. **Reasonable prevention procedures identified –** Perform high level review to assess the completeness of the reasonable prevention procedures identified.
5. **Implementation plan approach –** Assess the approach to implementation ensuring a structured plan was put in place with appropriate ownership, accountability and resources along with appropriate monitoring of delivery and progress against plan.
6. **Monitoring and review procedures –** Assess whether effective monitoring and review procedures have been (or are being) put in place, e.g. are appropriate governance and oversight bodies reviewing relevant MI & Metrics and are controls and assurance testing being undertaken?

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