



UNITED KINGDOM

International Comparison of Insurance Taxation

October 2007

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International Comparison of Insurance Taxation

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United Kingdom – General Insurance

1 Definition

Definition of property and casualty insurance company. This outline does not cover the taxation of Lloyd's Names

Accounting

A company to which insurance legislation applies, writing non-life insurance contracts in certain classes as specified in legislation.

Taxation

Not defined by tax legislation.

2 Commercial accounts/ tax and regulatory returns

Basis for the company's commercial accounts

Accounting

Companies Act 1985 (as amended) (CA85), which prescribes the UK GAAP or the IFRS. This outline does not deal with the IFRS. Further guidance and interpretation of the UK GAAP is provided by the Association of British Insurers' (ABI) Statement of Recommended Practice (SORP) on accounting for insurance business, first issued in December 1998 and revised in November 2003, December 2005 and December 2006.

EU-listed groups are required to prepare accounts in accordance with the International Financial Reporting Standards (IFRS) from 2005. While individual companies and unlisted groups are free to choose whether to apply IFRS, it is planned that the UK GAAP and the IFRS will converge over time.

Taxation

Based on commercial accounts.

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Regulatory return	A separate audited annual return is required by the insurance regulator, the Financial Services Authority (FSA). This return must be deposited with the FSA within two months and 15 days of the year end (three months if filed electronically). Basis of accounting is broadly in line with that for commercial accounts. Asset admissibility restrictions apply.	N/A.
Tax return	N/A.	A separate return is required by the HR Revenue & Customs (HMRC) – CT600.
3 Technical reserves/ Equalisation reserves Unearned premium reserves (UPR)	Accounting Written premiums should be recognised as earned income over the period of the policy, having regard to the incidence of risk. Time apportionment of the premium is normally appropriate unless there is a marked unevenness in the incidence of risk over the period of cover, in which case a basis that reflects the profile of risk should be used instead.	Taxation Tax deductible if in accordance with acceptable accounting practice.

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Unpaid claims reported (outstanding claims)

Provision should be made at the balance sheet date for the expected ultimate cost of settlement of all claims incurred in respect of events up to that date, whether reported or not, together with related claims handling expenses, less amounts already paid. If a liability is known to exist, but there is uncertainty as to its eventual amount, a provision should nevertheless be made.

There is no prescribed basis for the estimation of outstanding claims or claims incurred but not reported (IBNR) (see comments under 'Discounting charge', below). Generally, outstanding claims are calculated on a case-by-case basis or average claims settled method for some high-volume type claims.

The level of claims provisions should be set such that no adverse run-off deviation is envisaged.

Explicit discounting of claims provisions is allowed only if certain criteria laid down in CA85 are met. Such criteria include that:

- the expected average interval between the date or the settlement of claims being discounted and the accounting date is at least four years;
- there are adequate data available to construct a reliable model of the rate of claims settlement;
- assets are available that are appropriate in magnitude and nature to cover the liabilities discounted.

Normally tax deductible if justified by case estimates or statistical evidence (see comments under 'Discounting charge', below).

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Claims incurred but not reported (IBNR)	See above. Generally, calculated based on experience or statistical methods.	Tax deductible if justified by statistical evidence (see comments under 'Discounting charge', below).
Unexpired risks	Where the expected value of claims and expenses attributable to the unexpired periods of policies in force at the balance sheet date exceeds the unearned premiums provision in relation to such policies after deduction of any acquisition costs deferred, an unexpired risks provision should be established. An assessment of whether an unexpired risks provision is necessary should be made for each grouping of business that is managed, together with any unexpired risks surpluses and deficits within that grouping being offset. In calculating the expected value of future claims in relation to the unexpired periods of risk on policies in force at the balance sheet date, the future investment return arising on investments supporting the unearned premiums provision and the unexpired risks provision may be taken into account.	Tax deductible in accordance with accounting rules.
General contingency/solvency reserves	Not reflected in the Companies Act accounts.	Not allowed.

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Equalisation/catastrophe reserves

Prescribed for certain classes of business.

The amount shown as an equalisation reserve in the regulatory return is tax deductible, although an election may be made to treat it as non-deductible. Releases of reserves for which a tax deduction has been claimed are taxable.

These amounts are set aside for the purpose of mitigating exceptionally high loss ratios in future years.

Transfers in – by reference to that year's net written premium.

Transfers out – by reference to claims incurred and earned premium in that year.

Maximum reserve limit – by reference to net written premium for that year and previous four years.

Included within technical provisions in the commercial accounts.

4 Expenses/Refunds

Acquisition expenses

Accounting

Costs arising from the conclusion of insurance contracts including direct costs, such as acquisition commission or the cost of drawing up the insurance document or including the insurance contract in the portfolio, and indirect costs, such as advertising costs or the administrative expenses connected with the processing of proposals and the issuing of policies are deferred in line with the unearned premium.

Taxation

Allowed as per accounts.

Loss adjustment expenses on unsettled claims (claims handling expenses)

Provision made for all future claims handling costs both on outstanding claims and IBNR.

Allowed as per accounts, provided they can be justified (see comments under 'Discounting charge', below).



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Experience-rated refunds

If written premiums are subject to a reduction, an adjustment for such a reduction should be made as soon as it can be foreseen. Where written premiums are subject to an increase, retrospectively (for example based on the declaration of sums insured or on claims experience), recognition of potential increases should be deferred until the additional amount can be ascertained with reasonable certainty.

Taxable/deductible if calculation can be supported.

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5 Discounting charge

* For periods of account ending on or after the date of Royal Assent to the Finance Bill 2007 (expected to be June or July), a new regime will be introduced whereby HMRC can require an independent audit of the reserves amounts if they believe reserves are excessive. Any amounts determined to be excessive will not qualify for a tax deduction. Exceptionally, for the first period of account ending after Royal Assent, companies can disclaim up to 10% of their technical reserves for tax. Any amount added back as excessive or disclaimed will then be deductible in the following period of account. For earlier periods, as set out above, there is a requirement that normally general insurers should provide to the level of ultimate undiscounted losses. Indeed, the legal requirement is that provisions should be set at a level where redundancies, rather than additional provisions, should arise. These provisions are fully tax deductible at the time they are established. To counter the tax advantage obtained by setting provisions at these prudential levels, rather than 'best estimates', and to encourage the limitation of tax deductions, a 'finance charge' is applied to 'excessive deductions'. General insurers are attributed a finance charge, in the form of deemed additional profits, where the deduction claimed for the insurance technical provisions (reported and unreported claims and claims handling costs) exceeds the discounted value of ultimate claims costs. Paid claims and provisions are discounted back to the original year of deduction using a sterling risk-adjusted interest rate (unless the provisions are accounted for in a foreign currency when the relevant discount rate will be used, e.g. US Dollar provisions are discounted using a US Dollar discount rate) and, after an allowance of 5% of the discounted amount, are compared to the original deduction to ascertain the 'excessive' deductions claimed. The finance charge is calculated by applying the interest rate applicable for late payment of corporation tax, due by instalments to the excess amount. The finance charge may be mitigated by disclaiming a deduction for all or part of the insurance technical provisions. Where a general insurer claims a deduction for less than the discounted value of ultimate paid losses, it can claim a further deduction for the 'negative finance charge', subject to certain complex conditions. For companies making up accounts for each calendar year, the unpaid claims provisions (including claims handling provisions) for all years to 31 December 2000 are aggregated to that date and the first finance charge, subject to disclaimer of provisions, arises in 2001. The risk-adjusted sterling discount rate is the gross redemption yield applicable to five-year British Government Stocks, reduced by a risk margin of 2.3%. The interest rate for late payment of corporation tax is 1% over the bank base lending rate. Because the finance charge results in deemed additional profits rather than an interest expense, the rate is reduced by deducting the corporation tax rate. This legislation is due to be repealed for accounting periods beginning on or after 1 January 2007. As at the date of writing, it is expected that a new regime will be introduced, whereby HMRC can require an independent audit of the reserves amounts if they believe reserves are excessive. The precise details of the new regime, plus details of transitional rules for dealing with the unwind of the old regime, have not, at the date of writing, been published.

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6 Investments

Gains and losses on investments

Accounting

Realised and unrealised gains and losses on investments are recognised in the profit & loss (P&L) account. Investments are generally valued at market value. Fixed interest redeemable securities may be valued at amortised cost. Investment return must initially be recognised in the non-technical account (part of the P&L account) and may then be allocated to the general business technical account (also part of the P&L account) based on either actual investment returns or the longer term rate of return.

Taxation

Corporate and government debt has been taxed on a mark-to-market (MTM) basis since 1996, subject to transitional rules. The trade investments of most insurers have also been taxed on a MTM basis from 1 January 2002, subject to a right to elect for the continuation of the realisation basis for assets held on 31 December 2001 ('grandfathering'). The uplift in value from a realisation to MTM basis will normally be taxed in the year of change, subject to the 'grandfathering election' and a right to elect to spread the adjustment over six periods of account. Investment in subsidiaries and self-occupied buildings still qualify for capital gains treatment.

Investment reserves

No longer permitted (see above).

See above.

Investment income

Included in P&L on an accruals basis.

Generally taxed as trading income on an accruals/amortised cost basis. Rental income from investment properties taxed is also taxed on accruals basis. Overseas dividends are taxed on an arising basis. Dividends from UK companies are exempt from tax.

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United Kingdom – General Insurance *(continued)*

7 Reinsurance

Reinsurance premiums and claims

Accounting

Premiums paid/payable and claims recoveries are shown on the face of the P&L account. Financial reinsurance contracts are subject to special rules and disclosures.

Taxation

Follows accounts treatment.

8 Mutual companies

Mutual companies
(all profits returned to members)

Accounting

In principle as for all the other companies. ABI guidance applies.

Taxation

If truly mutual for tax purposes, which is rare, mutual companies are taxed on investment income, excluding income from UK dividends, capital movement on loan assets and most derivatives, and realised capital gains on land, shares and share-based collective investment schemes. Expenses of managing investments, as shown in the accounts after 31 March 2004, are deductible.

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United Kingdom – Other Tax Features

9 Further corporate tax features

Loss carry-overs

Taxation

One-year carry-back of trading losses – indefinite carry-forward against profits of the same trade.

Disclaimers made under the 'Discounting charges' regime (see above) unwind as additional tax-deductible expenses in the following period.

Current year losses may be utilised against other shareholder profits of the period or surrendered to group and consortium companies.

Foreign branch income

Taxable with credit for overseas tax.

Domestic branch income

Calculated under ordinary rules based on branch accounts. Notional investment return adjustments may be required where assets backing the business are held outside the UK permanent establishment (PE).

Corporate tax rate

30% for large companies reducing to 28% from 1 April 2008 (those with annualised profits greater than £1.5 million divided by one plus the number of associated companies). Lower rates apply for companies that are not large.

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United Kingdom – Other Tax Features *(continued)*

10 Other tax features

Premium taxes

Taxation

Premium tax of 5% where risk is located in UK. A rate of 17.5% applies to travel insurance and insurance connected with consumer products. Exemption for disability and transport.

Capital taxes

Stamp duty land tax on purchase of assets (other than shares) is at the following rates:

- Up to £125,000 and residential – exempt;
- Up to £150,000 and non-residential; or in a disadvantaged area – exempt;
- Up to £250,000 – 1%;
- Up to £500,000 – 3%;
- Above £500,000 – 4%.

So an acquisition of a property for £300,000 will give rise to a stamp duty land tax liability of £9,000.

Stamp duty/stamp duty reserve tax payable on purchase of shares at 0.5%.

Group relief can fully mitigate these charges.

Most forms of debt instrument are exempt.

Captive insurance companies

Taxable under controlled foreign company rules subject to exemption.

UK parent will also be subject to transfer pricing rules.

Value-added tax

Not included in this outline.

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United Kingdom – Life Insurance

1 Definition

Definition of Life Assurance companies

Accounting

A company other than a securitisation vehicle, which carries on life assurance business in the UK and to which specific regulations apply. Life assurance business must be written within the 'long-term insurance fund' of a life company.

Taxation

Specifically defined in tax legislation. Divided into six main categories of business – Basic Life Assurance and General Annuity Business (BLAGAB), Pension Business (PB), Life Reinsurance Business (LRB), Overseas Life Assurance Business (OLAB), Child Trust Fund Business (CTFB) and Individual Savings Account Business (ISAB). For periods of account beginning on or after 1 January 2007, the last five of these are merged into one category, Gross Roll-up Business (GRB). Capital Redemption Business (CRB) is dealt with as though it were BLAGAB. Other non-life long-term business is mostly as Permanent Health Insurance Business (PHI) and is taxed as general insurance business (although the provisions relating to the discounting charge discussed in the general insurance section do not apply). A shareholder-owned company may also maintain a shareholders' fund, the income and gains of which are taxed separately.

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United Kingdom – Life Insurance *(continued)*

2 Commercial accounts/ Tax and regulatory returns

Basis for the company's commercial accounts

Accounting

Companies Act 1985 (as amended) (CA85), which prescribes UK GAAP or IFRS. This outline does not deal with IFRS. Further guidance and interpretation of UK GAAP is provided by the Association of British Insurers' (ABI) Statement of Recommended Practice (SORP) on accounting for insurance business, first issued in December 1998 and revised in November 2003, December 2005 and December 2006. EU-listed groups are required to prepare accounts in accordance with International Financial Reporting Standards (IFRS) from 2005. While individual companies and unlisted groups are free to choose whether to apply IFRS, it is planned that UK GAAP and IFRS will converge over time.

Taxation

Most life assurance companies are taxed on the so-called income less expenses (I-E) basis. For the BLAGAB category of business the I-E basis taxes investment income, capital gains less management expenses and for other categories, PB, LRB, OLAB, CTFB and ISAB, trading profits are taxed (the calculations of the latter being referred to as Case VI computations). The effect of this is that shareholder and policyholder profits attributable to BLAGAB are taxed in the company, whereas for PB, LRB, OLAB, CTFB and ISAB, only shareholder profits are taxed. However, the I-E result is effectively disregarded if the result would be to tax less than the actuarial surplus arising from the life assurance business after a deduction for policyholder bonuses (an amount referred to as the Notional Case 1 (NC1)). In effect, the NC1 computation is used as a minimum profits calculation. In most cases this is achieved in practice by making a restriction of deductible expenses in the I-E computation until it gives the same (higher) result as the NC1 computation.

The commercial accounts are generally disregarded in the taxation of life assurance. The principal exception to this is in relation to the taxation of loan assets relating to BLAGAB, and interest and loan liabilities generally.

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United Kingdom – Life Insurance *(continued)*

For BLAGAB, the taxation of loan assets and liabilities is based on the amounts shown in the commercial accounts.

For other categories of business and the NC1 computation the commercial accounts are followed for loan relationships where the life assurer is the debtor. However, loan relationships where the company stands as creditor are taxed on the basis of the amounts shown in the regulatory return (see below).

Regulatory return

A separate annual return is required by the Financial Services Authority (FSA), two months and 15 days (three months if filed electronically) after the year-end date. The basis of accounting is broadly in line with that for commercial accounts. Asset admissibility restrictions apply for regulatory purposes.

The FSA return forms the basis of many of the tax computations for a life assurer. One exception to this, as discussed above, is that the taxation of some loan relationships is based on the commercial accounts instead.

Tax return

N/A.

Separate tax return as required by HMRC – form CT600.

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United Kingdom – Life Insurance *(continued)*

3 General approach to calculation of Income

Allocation of income between shareholders and policyholders

Accounting

Insurance legislation establishes the concept of the long-term insurance fund, ensuring that policyholder assets are not used by shareholders. Allocation of income and profits between shareholders and policyholders will also be determined by the constitution of the insurance contract (e.g. non-participating vs participating ('with profits')).

The ABI SORP sets out rules as to the treatment and allocation of investment return, including unrealised gains. The investment return arising during the period of account in relation to investments that are directly connected with the carrying on of long-term insurance business should initially be included in the technical account for long-term business. (These investments comprise those arising in, or attributed to, the long-term insurance fund, including the fund for future appropriations, together with such directly connected investments where the return accrues to shareholders, whether held within or outside the long-term business fund). It is then possible to reflect the longer term rate of return in the technical account by making an allocation of investment income to the non-technical account.

Taxation

Legislation specifies rules to allocate taxable income of the long-term insurance fund between policyholder and shareholder, for the purposes of identifying the appropriate rate of tax.

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United Kingdom – Life Insurance *(continued)*

Calculation of investment income and capital gains

See above.

Net income from land, gross interest and overseas dividends are taxable for all categories of business. Dividends from UK resident companies are exempt in the BLAGAB part of the I-E computation.

Gains and losses on investments

Recognised in the technical account or non-technical account as appropriate (see above).

Taxed in the I-E computation are:

- (a) BLAGAB realised gains and losses, computed under capital gains rules with relief for inflation;
- (b) Holdings in equity-based unit trusts or open-ended investment companies, real estate investment trusts and offshore funds are deemed to have been disposed of and reacquired at market value at the end of each accounting period. Where this gives rise to a capital gain or allowable loss, as is the case for all these investments except for certain offshore funds, one seventh of the BLAGAB element of the net capital gain is taxable in the I-E computation and the balance spread over the following six years. Allowable losses may be similarly spread, or carried back against the deemed disposal gains of the last two accounting periods on a last-in, first-out basis, with any balance being spread;
- (c) PB, LRB, OLAB, CTFB and ISAB net gains are taxed as income in the appropriate profits computation. The figure for net gains is taken generally from the FSA regulatory return.

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There are special rules for allocating income and gains across the various categories of business, and between life and non-life business. As the rules for allocating investment return to BLAGAB and PHI differ from those for allocating investment return to PB, LRB, OLAB, CTFB and ISAB, a company is not generally taxed on 100% of its investment return, but on an amount smaller or larger than 100%, depending on its particular circumstances.

Acquisition and maintenance expenses

Acquisition expenses are deferred by product type to the extent that margins are available. Such costs (which are not admissible assets for regulatory return purposes) should be deferred explicitly rather than implicitly as a reduction in reserves.

One-seventh of allowable BLAGAB acquisition costs are immediately deductible with the balance spread forward over the next six years. Maintenance expenses are allowed as incurred. For other categories of business there is no spreading and expenses are deductible as incurred. The distinction between acquisition and maintenance expenses for regulatory and tax purposes is not identical.

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United Kingdom – Life Insurance *(continued)*

4 Calculation of underwriting profits or total income

Actuarial reserves

Accounting

For regulatory purposes, specific valuation regulations govern the determination of long-term business provisions. Such provisions are determined on a prudent basis.

Guaranteed bonuses are recognised at the time that they are declared.

For commercial accounts purposes, the long-term business provision may be calculated on the basis used for reporting solvency, subject to the exclusion of the appropriate proportion of reserves (such as investment reserves, reserves to cover general contingencies and reserves to cover the specific contingency of the fund being closed to new business), taking account of the distinction between provisions and reserves.

Funds, the allocation of which either to policyholders or to shareholders, have not been determined by the end of the financial year are established as a liability in the fund for future appropriations (FFA). The gross premium method (which provides explicitly for vested bonuses and future reversionary bonuses, but not terminal bonuses) should be used for all classes of business except those for which the net premium method is used in the regulatory return.

Taxation

Mathematical reserves are tax deductible for NC1 and Case VI purposes. Reversionary bonuses declared in favour of policyholders or annuitants out of surplus are also deductible. It is not necessary for tax purposes to allocate the fund for future appropriations and conventionally the starting point for the NC1 and Case VI computations is the surplus arising for the period.

Releases of mathematical reserves, arising as a result of certain changes to FSA rules in 2006 or later years, will not be taxed in 2006, and instead will be taxed over the period 2007 to 2009. The same is true of similar releases of PHI reserves.

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United Kingdom – Life Insurance *(continued)*

Acquisition expenses	Deferred by product type to the extent that margins are available (as above).	The amounts charged in the regulatory return are deductible in the NC1 and Case VI computations, but are adjusted for certain items that are specifically disallowable.
Gains and losses on investments	Recognised in the technical account or non-technical account as appropriate (see above).	Realised and unrealised gains credited to the long-term business revenue account are taxed in the NC1 and Case VI computations.
Reserves against market losses on investments	See above. Investments are recognised at market value in the P&L account (technical or non-technical account as appropriate).	Allowed in NC1 and Case VI computations if taken into account in arriving at surplus.
Dividend income	Included in investment income.	Dividends from all companies, including UK resident companies, are taken into account in the NC1 and Case VI computations.
Policyholder bonuses	Included as an expense in the technical account.	Tax deductible in the NC1 and Case VI computations.
Other special deductions	None.	Special tax rules can apply to the receipt of contingent loans by life assurers.

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United Kingdom – Life Insurance *(continued)*

5 Reinsurance

Reinsurance

Accounting

Premiums paid/payable and recoveries disclosed separately on the face of the technical account. In order for a transaction to be accounted for as reinsurance there must be a transfer of significant insurance risk.

Taxation

Special tax regime applies for BLAGAB. Outwards reinsurance may give rise to an imputed investment return. Financial reinsurance may give rise to a loan relationship, depending upon the contractual form.

6 Mutual companies

Mutual companies

Accounting

No specific rules, although it is unlikely that a mutual will have a non-technical account.

Taxation

The normal I-E basis, including Case VI computations, applies except that there is no NC1 basis. Case VI tax is usually minimal for a mutual because the taxable surplus is generally offset by tax-deductible policyholder bonuses.

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United Kingdom – Other Tax Features

7 Further corporate tax features

Loss carry-overs

Taxation

One year carry-back, indefinite carry-forward of Case 1 losses against profits of the same trade. Case VI losses and capital losses carried forward indefinitely. Deemed losses on unit trusts may also be carried back against deemed profits of last two years.

Case 1 losses of the current period may be utilised against other shareholder profits of the period or surrendered to group or consortium companies.

Foreign branch income

Investment income and gains of an overseas life assurance fund are excluded from the I-E basis, but the surplus arising from such business is brought into account in an NC1 and Case VI computation.

Domestic branch income

Taxed under ordinary rules. May be subject to notional adjustments. Double-tax relief may be restricted. There is no branch tax.

Corporate tax rate

Shareholders' profits, calculated as the NC1 amount less an adjustment for BLAGAB UK dividends, are taxed at 30%; the balance of taxable profits are policyholders' profits and are taxed at 20%.

8 Policyholder taxation

Deductibility of premiums

Taxation

None except for pensions policies and for life policies that started before 14 March 1984. Although a deduction is given for premiums paid under pensions policies, subject to a cap, pension annuities when paid are taxed fully as income.

Interest build-up

For BLAGAB, taxed in the company as above, otherwise tax exempt.

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United Kingdom – Other Tax Features *(continued)*

Proceeds on death	Qualifying policies for BLAGAB are not subject to income or capital gains taxes, but may be subject to inheritance tax (IHT) if proceeds go to the estate. Gains on non-qualifying policies are subject to additional rate tax on surrender or maturity and may give rise to IHT.
9 Other tax features	Taxation
Premium taxes	None.
Capital taxes	<p>Stamp duty land tax on purchase of assets (other than shares) is at the following rates:</p> <ul style="list-style-type: none"> Up to £125,000 and residential – exempt; Up to £150,000 and non-residential; or in a disadvantaged area – exempt; Up to £250,000 – 1%; Up to £500,000 – 3%; Above £500,000 – 4%. <p>So an acquisition of a property for £300,000 will give rise to a stamp duty land tax liability of £9,000.</p> <p>Stamp duty/stamp duty reserve tax payable on purchase of shares at 0.5%. Transfers within groups of companies will not normally attract these charges. Most forms of debt instrument are exempt.</p>
Captive insurance companies	Taxable in the UK parent under controlled foreign company rules subject to exemption in some circumstances. UK parent will also be subject to transfer pricing rules.
Value-added tax	Not included in this outline.

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