TAXATION

	2019 £m	2018[1] £m
UK corporation tax:		
Current tax on profits for the year	**(1,389)**	(1,280)
Adjustments in respect of prior years	**96**	11
	(1,293)	(1,269)
Foreign tax:		
Current tax on profits for the year	**(70)**	(34)
Adjustments in respect of prior years	**2**	5
	(68)	(29)
Current tax charge	**(1,361)**	(1,298)
Deferred tax	**(26)**	(156)
Tax expense	**(1,387)**	(1,454)

1 Restated to reflect amendments to IAS 12, see note 1 on page F-13.

In 2019, a tax expense of £1,387 million arose on the profit before tax of £4,393 million and in 2018 a tax expense of £1,454 million arose on the profit before tax of £5,960 million.

The tax expense for 2019 represents an effective tax rate of 31.6 per cent compared to 24.4 per cent in 2018 and compared to a statutory corporation tax rate of 19.0 per cent in both 2018 and 2019. The increase in effective tax rate compared to 2018 was largely due to the increase in non-deductible conduct provision charges in relation to PPI, partially offset by the benefit of a prior year deferred tax adjustment.

DIVISIONAL INFORMATION

The requirements for IFRS segmental reporting are set out in IFRS 8, *Operating Segments* which mandates that an entity's segmental reporting should reflect the way in which its operations are viewed and judged by its chief operating decision maker. As a consequence, the Group's statutory segmental reporting follows the underlying basis as explained below (see also note 4 to the financial statements).

The Group Executive Committee, which is the chief operating decision maker for the Group, reviews the Group's internal reporting based around these segments (which reflect the Group's organisational and management structures) in order to assess performance and allocate resources. The segments are differentiated by the type of products provided and by whether the customers are individuals or corporate entities and the performance assessment includes a consideration of each segment's net interest revenue; consequently the total interest income and expense for all reportable segments is presented on a net basis. The internal reporting is on an underlying profit before tax basis. The Group Executive Committee believes that this basis better represents the underlying performance of the Group. IFRS 8 requires that the Group presents its segmental profit before tax on the basis reviewed by the chief operating decision maker that is most consistent with the measurement principles used in measuring the Group's statutory profit before tax. Accordingly, the Group presents its segmental underlying basis profit before tax in note 4 to the financial statements.

The aggregate total of the underlying basis segmental results constitutes a non-GAAP measure as defined in the United States Securities and Exchange Commission's Regulation G. Management uses aggregate underlying profit before tax, a non-GAAP measure, as a measure of performance and believes that it provides important information for investors because it is a comparable representation of the Group's performance. Profit before tax is the comparable GAAP measure to aggregate underlying profit before tax. The table below sets out the reconciliation of this non-GAAP measure to its comparable GAAP measure.

The Group's activities are organised into three financial reporting segments: Retail; Commercial Banking; and Insurance and Wealth.

During 2019, the Group transferred Cardnet, its card payment acceptance service, from Retail into Commercial Banking and also transferred certain equity business from Commercial Banking into Central items. Comparatives have been restated accordingly.

Comparisons of results on a historical consolidated statutory basis are impacted by a number of items. In order to provide more meaningful and relevant comparatives, the results of the Group and divisions are presented on an 'underlying' basis. The following items are excluded in arriving at underlying profit:

- restructuring, including severance-related costs, the costs of implementing regulatory reform including ring-fencing, the rationalisation of the non-branch property portfolio, the establishment of the Schroders strategic partnership, the integration of MBNA and Zurich's UK workplace pensions and savings business;
- market volatility and other items, which includes the effects of certain asset sales, the volatility relating to the Group's own debt and hedging arrangements and that arising in the insurance businesses and insurance gross up, the unwind of acquisition-related fair value adjustments and the amortisation of purchased intangible assets; and
- payment protection insurance provisions.

The results of the businesses are set out below on the underlying basis:

	2019 **£m**	2018[1] £m
Retail	**3,839**	4,211
Commercial Banking	**1,777**	2,183
Insurance and Wealth	**1,101**	927
Other	**814**	745
Underlying profit before tax	**7,531**	8,066

1 Segmental analysis restated, as explained above.

Reconciliation of statutory profit to underlying profit before tax for the year

	Note	2019 £m	2018 £m
Statutory profit before tax		**4,393**	5,960
Market volatility and asset sales	1	**(126)**	50
Amortisation of purchased intangibles	2	**68**	108
Restructuring costs	3	**471**	879
Fair value unwind and other items	4	**275**	319
Payment protection insurance provision	5	**2,450**	750
Underlying profit before tax		**7,531**	8,066

1. Market volatility and asset sales

Market volatility and asset sales of £126 million included adverse movements in banking volatility and a gain on establishment of the Schroders Personal Wealth joint venture as well as the one-off charge for exiting the Standard Life Aberdeen investment management agreement. Also included was positive insurance and policyholder interests volatility, which is a deduction from statutory profit before tax in the reconciliation above, totalling £76 million compared to negative volatility of £103 million in 2018.

This insurance and policyholder interests volatility comprises the following:

	2019 £m	2018 £m
Insurance volatility	**230**	(506)
Policyholder interests volatility	**193**	46
Insurance hedging arrangements	**(347)**	357
Total	**76**	(103)

Management believes that excluding volatility from underlying profit before tax provides useful information for investors on the performance of the business as it excludes amounts included within profit before tax which do not accrue to the Group’s equity holders and excludes the impact of changes in market variables which are beyond the control of management.

The most significant limitations associated with excluding volatility from the underlying basis results are:

(i) Insurance volatility requires an assumption to be made for the normalised return on equities and other investments; and

(ii) Insurance volatility impacts on the Group’s regulatory capital position, even though it is not included within underlying profit before tax.

Management compensates for the limitations above by:

(i) Monitoring closely the assumptions used to calculate the normalised return used within the calculation of insurance volatility; these assumptions are disclosed below; and

(ii) Producing separate reports on the Group’s current and forecast capital ratios.

Insurance volatility

The Group’s insurance business has policyholder liabilities that are supported by substantial holdings of investments. IFRS requires that the changes in both the value of the liabilities and investments are reflected within the income statement. The value of the liabilities does not move exactly in line with changes in the value of the investments. As the investments are substantial, movements in their value can have a significant impact on the profitability of the Group. Management believes that it is appropriate to disclose the division’s results on the basis of an expected return in addition to results based on the actual return. The impact of the actual return on these investments differing from the expected return is included within insurance volatility.

The expected gross investment returns used to determine the underlying profit of the business are based on prevailing market rates and published research into historical investment return differentials for the range of assets held. The basis for calculating these expected returns reflects an average of the 15 year swap rate over the preceding 12 months updated throughout the year to reflect changing market conditions. The volatility movements in the period were largely driven by insurance volatility arising from equity market movements and credit spreads. The capital impact of equity market movements is hedged within Insurance and this also reduces the IFRS earnings exposure.

Policyholder interests volatility

The application of accounting standards results in the introduction of other sources of significant volatility into the pre-tax profits of the life, pensions and investments business. In order to provide a clearer representation of the performance of the business, and consistent with the way in which it is managed, adjustments are made to remove this volatility from underlying profits. The effect of these adjustments is separately disclosed as policyholder interests volatility.

Accounting standards require that tax on policyholder investment returns relating to life products should be included in the Group’s tax charge rather than being offset against the related income. The result is, therefore, to either increase or decrease profit before tax with a related change in the tax charge. Timing and measurement differences exist between provisions for tax and charges made to policyholders. Consistent with the expected approach taken in respect of insurance volatility, differences in the expected levels of the policyholder tax provision and policyholder charges are adjusted through policyholder interests volatility. In 2019, the statutory results before tax included a credit to other income which relates to policyholder interests volatility totalling £193 million reflecting movements in equity, bond and gilt returns relating to life products.