TAXATION

	2017 £m	2016 £m	2015 £m
UK corporation tax:			
Current tax on profits for the year	**(1,346)**	(1,010)	(485)
Adjustments in respect of prior years	**126**	156	(90)
	(1,220)	(854)	(575)
Foreign tax:			
Current tax on profits for the year	**(40)**	(20)	(24)
Adjustments in respect of prior years	**10**	2	27
	(30)	(18)	3
Current tax (charge) credit	**(1,250)**	(872)	(572)
Deferred tax	**(478)**	(852)	(116)
Tax expense	**(1,728)**	(1,724)	(688)

2017 COMPARED WITH 2016

In 2017, a tax expense of £1,728 million arose on the profit before tax of £5,625 million and in 2016 a tax expense of £1,724 million arose on the profit before tax of £3,888 million. The statutory corporation tax rates were 19.25 per cent for 2017 and 20 per cent for 2016.

The tax expense for 2017 represents an effective tax rate of 31 per cent; the high effective tax rate in 2017 was largely due to the banking surcharge, and restrictions on the deductibility of conduct provisions.

2016 COMPARED WITH 2015

In 2016, a tax expense of £1,724 million arose on the profit before tax of £3,888 million and in 2015 a tax expense of £688 million arose on the profit before tax of £1,644 million. The statutory corporation tax rates were 20 per cent for 2016 and 20.25 per cent for 2015.

The tax expense for 2016 represented an effective tax rate of 44 per cent; the high effective tax rate in 2016 was largely due to the banking surcharge, restrictions on the deductibility of conduct provisions and the negative impact on the net deferred tax asset of both the change in corporation tax rate and the expected utilisation by the life assurance business.

LINE OF BUSINESS 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, by whether the customers are individuals or corporate entities and by the geographical location of the customer 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.

As part of a Group restructuring during 2017:

- the Consumer Finance division has now become part of Retail;
- the Group's UK wealth business, previously part of Retail, has been transferred to the Insurance division, now renamed Insurance and Wealth;
- the Group's International wealth business, previously part of Retail, has been transferred to the Commercial Banking division; and
- the Group's venture capital business, previously part of Commercial Banking, has been transferred to Other.

Comparatives have been restated accordingly. Following this restructuring, the Group's activities are now organised into three financial reporting segments: Retail; Commercial Banking; and Insurance and Wealth.

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:

- losses on redemption of the Enhanced Capital Notes and the volatility in the value of the embedded equity conversion feature;
- market volatility and asset sales, 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;
- restructuring costs comprising costs relating to the Simplification programme and the costs of implementing regulatory reform and ring fencing, rationalisation of the non-branch property portfolio and the integration of MBNA;
- TSB build and dual running costs and the loss relating to the TSB sale in 2015; and
- payment protection insurance and other conduct provisions,

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

	2017 **£m**	2016[1] £m	2015[1] £m
Retail	**4,403**	4,058	4,255
Commercial Banking	**2,489**	2,379	2,383
Insurance and Wealth	**939**	973	1,090
Other	**662**	457	384
Underlying profit before tax	**8,493**	7,867	8,112

1 Segmental analysis restated, as explained above.

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

	Note	**2017 £m**	2016 £m	2015 £m
Underlying profit before tax		**8,493**	7,867	8,112
Enhanced Capital Notes	1	**–**	(790)	(101)
Market volatility and asset sales	2	**279**	439	(81)
Amortisation of purchased intangibles	3	**(91)**	(340)	(342)
Restructuring and TSB dual running costs	4	**(621)**	(622)	(255)
Charge relating to TSB disposal	5	**–**	–	(660)
Fair value unwind and other items	6	**(270)**	(231)	(192)
Payment protection insurance provision	7	**(1,300)**	(1,350)	(4,000)
Other conduct provisions	8	**(865)**	(1,085)	(837)
Statutory profit before tax		**5,625**	3,888	1,644

1. Enhanced Capital Notes

The Group completed tender offers and redemptions in respect of its Enhanced Capital Notes (ECNs) in March 2016, resulting in a net loss to the Group of £721 million in the year ended 31 December 2016, principally comprising the write-off of the embedded equity conversion feature and premiums paid under the terms of the transaction. In addition there was a charge of £69 million reflecting the change in fair value of the embedded equity conversion feature in the period prior to the transaction.

In the year ended 31 December 2015, a charge of £101 million arose from the change in fair value of the embedded equity conversion feature.

2. Market volatility and asset sales

Market volatility and asset sales of £279 million included positive volatility in the insurance business of £286 million. The credit of £439 million in 2016 included the gain on sale of Visa Europe of £484 million partly offset by negative volatility in the insurance business of £91 million.

The Group's statutory result before tax is affected by insurance volatility, caused by movements in financial markets, and policyholder interests volatility.

In 2017, the Group's statutory result before tax included positive insurance and policyholder interests volatility totalling £286 million compared to negative volatility of £91 million in 2016 and negative volatility of £105 million in 2015.

Volatility comprises the following:

	2017 £m	2016 £m	2015 £m
Insurance volatility	**196**	(152)	(303)
Policyholder interests volatility	**190**	241	87
Insurance hedging arrangements	**(100)**	(180)	111
Total	**286**	(91)	(105)

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 positive insurance volatility during 2017 of £196 million primarily reflects positive returns on equities.

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