

# INCOME TAX (TRADING AND OTHER INCOME) ACT 2005

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## EXPLANATORY NOTES

### COMMENTARY ON SECTIONS

#### *Schedule 2: Transitionals and savings etc.*

#### **Part 6: Savings and investment income: insurance contracts and policies made before certain dates**

##### **Overview**

3585. This Part of Schedule 1 applies for the purposes of Chapter 9 of Part 4 of this Act.
3586. The paragraphs in this Part set out the further rules that apply to policies issued in respect of insurances made or contracts made before certain dates. The paragraphs appear in the chronological order of those dates. These rules largely reflect the commencement provisions applying to the various amendments to the source legislation.
3587. *Part 7* of this Schedule contains further rules that apply in respect of policies and contracts pre-dating 17 March 1998 that may be personal portfolio bonds.
3588. Other transitional provisions in respect of Chapter 9 of Part 4 of this Act are provided in Part 5 of this Schedule.

#### *Paragraph 96: Pre-20th March 1968 policies and contracts excluded from Chapter 9 of Part 4*

3589. This paragraph excludes certain policies and contracts from the scope of Chapter 9 of Part 4 of this Act. It is based on section 539 of ICTA.
3590. *Sub-paragraph (2)* removes that exclusion where the policy or contract is varied after the relevant date in certain circumstances. This is a common feature of the chargeable event gains regime. It prevents the exploitation of policies and contracts which benefit from a particular rule in relation to a specific date, where the later variation could increase the value of that benefit to a degree not contemplated by the provision.
3591. *Sub-paragraph (3)* restricts the effect of sub-paragraph (2) where the variation was made by 31 December 1968 to comply with certain provisions for qualifying policies (as at that time, under the predecessor to Schedule 15 of ICTA).

#### *Paragraph 97: Pre-27th March 1974 policies and contracts: disapplication of section 500(c)*

3592. This paragraph reflects the commencement provisions in the source legislation for sections 500(c) and 501, which treat certain loans as part surrenders of a policy or contract. It is based on section 548(1) of ICTA.

***Paragraph 98: Pre-27th March 1974 contracts: disapplication of section 531(3)(c)***

3593. This paragraph reflects the commencement provisions in the source legislation for the treatment of gains from certain contracts for a life annuity. It is based on section 547(5A) of ICTA.

***Paragraph 99: Pre-10th December 1974 contracts for a life annuity: disapplication of section 484(1)(d)***

3594. This paragraph reflects the commencement provisions in the source legislation for the treatment of death as giving rise to a surrender of the rights under a contract for a life annuity. It is based on section 542(2) of ICTA.

***Paragraph 100: Pre-14th March 1975 policies and contracts: calculation of gains under section 507***

3595. This paragraph applies to policies and contracts which are more than 20 years old. Premiums paid on such policies 20 or more years ago will be 100% allowable in computations of gains, subject to the restriction this paragraph applies in respect of years beginning before 14 March 1975. It introduces, for the policies and contracts to which it applies, the concept of a “reference period”, defined in *sub-paragraph (6)* as insurance years beginning after 13 March 1975. Where the paragraph applies, it affects the periodic calculation under section 507. It is based on section 546(1) of ICTA.
3596. *Sub-paragraph (3)* limits by reference to that reference period the period within which certain assignments contribute amounts in the calculation under section 507 of the “net total value” of rights assigned.
3597. *Sub-paragraphs (4)* and *(5)* amend the calculation to allow a portion of each premium paid before the reference period and during the reference period in the total of “net total allowable payments”. The portion allowed cannot exceed 100% of a premium paid in a year falling wholly in the reference period. If the premium was paid in an insurance year beginning before the reference period, the allowable amount diminishes the earlier the premium was paid. For each such premium, one-twentieth is “lost” for each year beginning before the reference period, back to and including the year the premium was paid.

***Paragraph 101: Pre-25th March 1982 replacement policies: disapplication of section 542***

3598. This paragraph is based on paragraph 20(4) of Schedule 15 to ICTA. A replacement policy issued before 25 March 1982 is not treated as a single policy with the one it replaced, but as a freshly issued policy in, for example, the calculation of “N” in section 536 (calculations for top slicing relief).

***Paragraph 102: Certain pre-26th June 1982 policies and contracts excluded from Chapter 9 of Part 4***

3599. Before FA 1983, gains on “second hand” life insurance policies and life annuity contracts (that is, where all the rights had previously been assigned for money or money’s worth) were subject to capital gains tax rather than income tax. The gain was computed under capital gains tax rules.
3600. This paragraph preserves that treatment so long as none of the events set out in *sub-paragraphs (3)* to *(5)* occurs after 23 August 1982. Should such an event occur, the policy or contract comes again within the scope of Chapter 9 of Part 4 of this Act. The paragraph is based on sections 540, 542 and 544 of ICTA.
3601. *Sub-paragraphs (5)* to *(9)* provide that certain loans made by, or by arrangement with, the issuer of the policy or contract to, or at the direction of, an individual bring the assigned policy or contract back into the scope of Chapter 9 of Part 4 of this Act. They

ensure that the treatment of such loans corresponds with the rules (including exceptions) in section 501.

3602. Sub-paragraph (6) ensures that the individual mentioned in sub-paragraph (5) is within the scope of that provision even where the rights under the policy or contract are held under a charitable trust that individual created (although a gain would not be attributed to that individual under section 465 in such circumstances).
3603. Sub-paragraph (9) ensures that the loan bringing the policy back within the scope of Chapter 9 of Part 4 of this Act is treated as a part surrender by virtue of section 500.

***Paragraph 103: Certain pre-18th November 1983 policies not foreign policies of life insurance***

3604. This paragraph is based on section 553A of ICTA. The paragraph reflects the commencement provisions for the source legislation.
3605. The exclusion of a policy to which this paragraph applies from the scope of Chapter 9 of Part 4 of this Act is lost if the policy is varied in certain ways. See the commentary above on the similar provision in paragraph 96 (pre-20th March 1968 policies and contracts excluded from Chapter 9 of Part 4).
3606. See also the commentary below for paragraph 111 (certain pre-17th March 1998 policies not foreign policies of life insurance).

***Paragraph 104: Certain pre-23rd February 1984 policies not foreign capital redemption policies***

3607. This paragraph is based on section 553(10) of ICTA. That section defines a “new offshore capital redemption policy” (the equivalent term in the source legislation for a “foreign capital redemption policy”). This paragraph reflects the commencement provisions for that source legislation. See also the commentary for paragraph 113 (certain pre-23rd March 1999 policies not foreign capital redemption policies).

***Paragraph 105: Pre-14th March 1984 policies: disregard of amounts deducted and repaid after tax relief by deduction from premiums abolished***

3608. Certain amounts were treated under section 72(9) of FA 1984 as additional premiums paid on 5 August 1984 only. This treatment arose exceptionally from the abolition of the right to deduct tax relief from premiums paid to the insurer and applied for limited purposes (which did not include the calculation of chargeable event gains). This paragraph ensures that such amounts are disregarded in computing gains for the purposes of certain calculations in Chapter 9 of Part 4 of this Act. It is based on section 541(6) of ICTA.

***Paragraph 106: Certain pre-20th March 1985 policies: application of section 529(1)***

3609. This paragraph is based on section 553(5) of ICTA. It reflects the insertion by FA 1985 of an exception to rules introduced by FA 1984. The FA 1984 rules provided for the reduction of gains where the policy holder was not UK resident during all or part of the policy period (see section 528 of this Act).
3610. The exception applies when the policy is held at the time of the chargeable event by one or more non-UK resident trustees.
3611. The paragraph reverses the exception made by section 529 if the policy was held by such a trustee or trustees on 19 March 1985 and the policy was issued in respect of an insurance (for a policy of life insurance) or contract (for a capital redemption policy) made on or before that date.

3612. The paragraph also repairs an omission in the source legislation which would exclude a capital redemption policy from the benefit of the paragraph. In the source legislation, the reduction under section 553(3) of ICTA is only made if, under section 553(5A) (a) of ICTA, the policy was *issued in respect of an insurance* made before 17 March 1998. The term used in that paragraph is only apt for a policy of life insurance, although section 553(5) of ICTA covers capital redemption policies too, and the opening words of section 553(5) of ICTA are apt for both since they just refer to “the policy”. Instead of saying “issued in respect of an insurance made”, section 553(5)(a) of ICTA should have also have referred to a capital redemption policy “issued in respect of a contract made”. In practice, section 553(5) of ICTA is interpreted as if it referred also to the making of contracts for capital redemption policies.

***Paragraph 107: Pre-14th March 1989 qualifying policies: application of section 485(2)(b) and (3)(b)***

3613. This paragraph reflects the commencement provisions for paragraph (b) in section 485(2) and (3). Paragraph (b) affects the incidence of chargeable events, in respect of a qualifying policy, where the rights under the policy are held as security for a debt owed by a company. This paragraph is based on section 540(5A) of ICTA.
3614. But the modification by this paragraph of section 485(2) and (3) is removed (and the incidence of chargeable events thereby increased) if the pre-14th March 1989 policy is varied in certain ways. See the commentary above on the similar provision in paragraph 96 (pre-20th March 1968 policies and contracts excluded from Chapter 9 of Part 4). *Sub-paragraphs (2) and (3)* are based on section 539(9) of ICTA.

***Paragraph 108: Pre-14th March 1989 policies and contracts: application of section 501***

3615. This paragraph is based on section 548(3A) of ICTA. It limits the application of section 501 (loans by insurers giving rise to part surrenders) where:
- the policy or contract dates from before 14 March 1989; and
  - the rights under the policy or contract were held in circumstances such that a company would be liable to tax under section 547(1)(b) of ICTA on a gain arising on that policy or contract.
3616. *Sub-paragraphs (2) and (3)* remove the limitation on the scope of section 501 if the policy is varied in certain ways. See the commentary above on the similar provision in paragraph 96 (pre-20th March 1968 policies and contracts excluded from Chapter 9 of Part 4). These sub-paragraphs do not apply to a life annuity contract. They are based on section 539(9) of ICTA.

***Paragraph 109: Contracts in accounting periods beginning before 1st January 1992: disapplication of sections 530 and 539(3)***

3617. This paragraph modifies the application of a number of provisions in Chapter 9 of Part 4 of this Act to certain life annuity contracts. The contracts affected are defined by reference to dates in 1974 (as regards the contract) and 1992 (as regards the insurer). Between those dates, the investment profits of the insurer in respect of such contracts did not bear UK tax. These contracts are therefore treated similarly to foreign policies and contracts. The paragraph is based on sections 547 and 549 of ICTA.
3618. *Sub-paragraphs (2) and (3)* deny such contracts the income tax allowance etc provided by section 530 unless either section 532 or section 534 applies. Certain other life annuity contracts are also denied that allowance (subject to the same exceptions) by section 531.
3619. This sub-paragraph does not apply in the computation of top slicing relief. The effect of this is to give equal, rather than more favourable treatment under that relief, compared

to that given to policies and contracts whose underlying investment profits have borne UK tax.

3620. *Sub-paragraph (4)*, however, provides that the tax relief due under section 539 for a corresponding deficiency may extend to rates other than the higher rate for such a contract. This recognises the fact that a gain on a calculation event in respect of such a contract will have been charged at the starting and lower rates as well as the higher rate (where applicable).
3621. *Sub-paragraph (5)* amplifies the source legislation by providing a definition of “accounting period”. The term is used in Chapter 2 of Part 13 of ICTA (see section 547(5A)(b) of ICTA) but the meaning there has to be assumed, given that the terms of reference of the definition in section 834(1) of ICTA (which refers to section 12 of that Act) do not include that Chapter as it applies for income tax purposes.

***Paragraph 110: Certain pre-17th March 1998 policies: application of section 529(1)***

3622. This paragraph deals with a similar circumstance to that in paragraph 106 (certain pre-20th March 1985 policies: application of section 529(1)). It is based on section 553(5A) of ICTA.
3623. FA 1998 introduced an exception which limits the availability of the reduction of a gain for periods of non-UK residence on the part of the policy holder (see section 528), where the policy of life assurance or capital redemption policy is held by a foreign institution (see the definition of that term in section 468(5)).
3624. The paragraph reverses the exception made by section 529 if the policy was held by a foreign institution on 16 March 1998 and the policy was issued in respect of an insurance (for a policy of life insurance) or contract (for a capital redemption policy) made on or before that date.
3625. As in paragraph 106 (certain pre-20th March 1985 policies: application of section 529(1)), this paragraph repairs an omission in the source legislation which would exclude a capital redemption policy from the benefit of the paragraph.

***Paragraph 111: Certain pre-17th March 1998 policies not foreign policies of life insurance***

3626. This paragraph reflects the fact that the commencement provisions for the source legislation relevant to the paragraph (a) and paragraph (b) elements of the definition of a “foreign policy of life insurance”, in section 476(3), use different dates. It is based on section 553A of ICTA.
3627. *Sub-paragraph (1)* effectively states the general rule that policies issued in respect of an insurance made before 17 March 1998 are not foreign policies of life insurance unless certain conditions are met. This ensures that policies falling within the paragraph (b) element of the definition do so only if they are issued in respect of an insurance made on or after that date.
3628. The sub-paragraph then identifies the conditions which disapply the basic rule. These are where policies are within the paragraph (a) element of the definition (subject to the commencement provisions in paragraph 103 (certain pre-18th November 1983 policies not foreign policies of life insurance)).
3629. As was the case for paragraph 103 (certain pre-18th November 1983 policies not foreign policies of life insurance), the paragraph is based on section 553A of ICTA.
3630. *Sub-paragraphs (2) and (3)* disapply the general rule in sub-paragraph (1) if the policy is varied in certain ways. See the commentary on the similar provision in paragraph 96 (pre-20th March 1968 policies and contracts excluded from Chapter 9 of Part 4).



**Paragraph 112: Pre-17th March 1998 policy or contract: UK resident trustees**

3631. This paragraph reflects the commencement provisions for the source legislation, which deals with the liability of UK resident trustees. It is based on paragraph 7 of Schedule 14 to FA 1998.
3632. In addition to the usual provision in *sub-paragraph (3)* defining the policies and contracts, gains from which are not to be attributed to trustees, and the usual reservation in *sub-paragraph (4)* for policies and contracts subsequently varied, *sub-paragraph (1)* prescribes a date condition and a settlor condition.

**Paragraph 113: Certain pre-23rd March 1999 policies not foreign capital redemption policies**

3633. This paragraph reflects the fact that the commencement provisions for the source legislation relevant to the paragraph (a) and paragraph (b) elements of the definition of a “foreign capital redemption policy”, in section 476(3), have different dates. It is similar in approach to that in paragraph 111 (certain pre-17th March 1998 policies not foreign policies of life insurance). As was the case for paragraph 104 (certain pre-23rd February 1984 policies not foreign capital redemption policies), the paragraph is based on sections 553(10) and 553B of ICTA.
3634. The paragraph sets out a general rule that policies issued in respect of an insurance made before 23 March 1999 are not foreign capital redemption policies, unless conditions are met which only affect policies within the paragraph (a) element of the definition in section 476(3). This ensures that policies falling within the paragraph (b) element of the definition do so only if they are issued in respect of a contract made on or after that date.
3635. Those conditions, under which an older policy is a foreign capital redemption policy, are that the policy is within the paragraph (a) element of the definition, subject to the commencement provisions in paragraph 104 (certain pre-23rd February 1984 policies not foreign capital redemption policies).

**Paragraph 114: Pre-9th April 2003 contract or policy: UK resident trustees**

3636. This paragraph reflects the commencement provisions for the source legislation which introduced the provision rewritten as condition C in section 467(5). It is based on section 547(4A) of ICTA.
3637. *Sub-paragraphs (2) and (3)* define the policies and contracts, gains from which benefit from this exception to the scope of section 467, and disapply the exception in *sub-paragraph (1)* if the policy or contract is varied in certain ways. (See the commentary above on the similar provision in paragraph 96 (pre-20th March 1968 policies and contracts excluded from Chapter 9 of Part 4).) These sub-paragraphs are based on paragraph 12 of Schedule 34 to FA 2003.
3638. *Sub-paragraphs (3) and (4)* incorporate a correction to the source legislation, so that it applies in the case of a life annuity contract as it does in the case of a policy of life insurance or a capital redemption policy. Paragraph 12(4)(a) of Schedule 34 to FA 2003 finishes with the words “(any exercise of rights conferred by *the policy* being regarded for this purpose as a variation)”. It should refer to *the policy or contract*.
3639. No distinction between policies and contracts was intended and it is clear from the opening words of paragraph 12 of Schedule 34 to FA 2003, which refer to “A policy or contract”, that both are in mind. This paragraph makes clear that, if rights conferred by a contract for a life annuity made before 9 April 2003 are exercised on or after that date, the contract is regarded as having been varied. These sub-paragraphs are based on paragraph 12 of Schedule 34 to FA 2003.

***Paragraph 115: Pre-9th April 2003 contract or policy: loans to trustees***

3640. This paragraph reflects the commencement provisions for the source legislation which added loans to trustees to the scope of the provisions rewritten in sections 500(c) and 501. It is based on paragraph 9 of Schedule 34 to FA 2003.

***Paragraph 116: Pre-9th April 2003 contract or policy: excepted group life policies***

3641. This paragraph is based on paragraph 4 of Schedule 34 to FA 2003. *Sub-paragraphs (1) and (4)* of this paragraph carry the benefit of paragraph 4(1) of Schedule 34 to FA 2003 for certain group life policies through the date (6 April 2005) from which this Act has effect. The policies in question were taken out before 9 April 2003, and would not otherwise satisfy the conditions in sections 481 and 482 for the exclusion provided by section 480, but had benefited under paragraph 4(1) of Schedule 34 to FA 2003.
3642. Paragraph 4(1) of Schedule 34 to FA 2003 provided a period in which, subject to conditions, a group life policy, not satisfying the conditions in section 539A of ICTA for exclusion under section 539(2)(f) of ICTA from the scope of Chapter 2 of Part 13 of that Act, could be varied to comply with section 539A of ICTA. That paragraph also provided that such a policy, if varied, would be treated as having complied with those conditions.
3643. *Sub-paragraphs (2) and (3)* similarly preserve the treatment of a replacement policy and the replaced policy under paragraph 4(3) of Schedule 34 to FA 2003 as a single policy, where the replacement was made to comply with section 539A of ICTA.

***Paragraph 117: Pre-3rd March 2004 contract or policy: calculation of deficiencies***

3644. This paragraph reflects the commencement provisions for the restriction in section 541 of relief for a deficiency under section 539 by reference to gains for which the individual in question has been liable to tax. It is based on section 140 of FA 2004.
3645. As is usual, the benefit of this paragraph is lost if the policy or contract is varied in certain ways after the relevant commencement date.

***Paragraph 118: Pre-1st January 2005 contracts for immediate needs annuities: income tax treated as paid***

3646. FA 2004 placed certain annuities in a different category, for the purposes of the tax charge on insurance companies, and provided an exemption from income tax on the annuity payments (see section 725 of this Act). This paragraph ensures that any such annuities in existence at the beginning of 2005 do not, by reason of the change to the taxation rules for insurance companies, lose entitlement to the income tax allowance under section 530. It is based on section 147 of FA 2004.