These notes refer to the Finance (No. 2) Act 2010 (c.31) which received Royal Assent on 27 July 2010

FINANCE (NO. 2) ACT 2010

EXPLANATORY NOTES

Section 1: Main Rate of Corporation Tax for Financial Year 2011

Summary

1. Section 1 amends the main rate of corporation tax for the financial year beginning 1 April 2011 and sets it at 27 per cent for companies with profits other than ring fence profits of North Sea oil companies.

Details of the Section

2. Section 1 amends section 2(2)(a) of the Finance Act 2010, to set the main rate of corporation tax, for non-ring fence profits, at 27 per cent for the financial year 2011.

Background Note

3. The main rate of corporation tax is paid by companies with profits over and above the upper limit (currently £1.5 million).

4. Where two or more companies are associated with one another, the upper limit is reduced. This is done by dividing the limit by the number of associated companies.

5. Companies with profits from oil extraction and oil rights in the UK and the UK Continental Shelf ("ring fence profits") will continue to be subject to a separate main rate of corporation tax applicable to those ring fenced profits. This will remain at 30 per cent. Profits from activities which are not ring fenced will continue to be charged at the main rate of corporation tax applicable to all other profits.

Section 2Schedule 1: Rates of Capital Gains Tax

Summary

1. Section 2 and Schedule 1 change the rates at which capital gains tax (CGT) is charged. This replaces the single rate of 18 per cent for all gains (with gains qualifying for entrepreneurs' relief being reduced to deliver an effective rate of 10 per cent).

2. The rate of CGT for gains that do not qualify for entrepreneurs' relief will now be:

   - 18 per cent up to any unused amount of an individual's income tax basic rate band; and
   - 28 per cent for other gains, including gains of trustees and the personal representatives of deceased persons.

3. The 10 per cent rate for gains qualifying for entrepreneurs' relief remains, but is now delivered simply by charging those gains at that rate, and the lifetime limit for gains qualifying for the relief is increased from £2 million to £5 million.

4. The changes take effect for gains arising on or after 23 June 2010.

Details of the Schedule

5. Paragraph 2 of the Schedule replaces section 4 of the Taxation of Chargeable Gains Act 1992 (TCGA), which previously provided that all gains were chargeable to CGT at a rate of 18 per cent, and adds new section 4A.

Details of the revised section 4 and the new section 4A of TCGA

6. Subsection (1) of the revised section 4 provides for the section to prescribe the rates at which CGT is chargeable, and that the section is subject to section 169N of TCGA (which provides rules for charging CGT on gains qualifying for entrepreneurs' relief).

7. Subsections (2) to (4) provide that the rate of CGT is 18 per cent, (subject to other provisions of the section), and that the gains of trustees and personal representatives, and individuals liable to income tax at higher rates, are to be charged at 28 per cent.

8. Subsections (5) to (9) have the effect that where an individual's taxable income for a tax year is less than their basic rate band, gains up to the amount of the unused portion of the basic rate band are charged at 18 per cent. Gains above that limit are charged at 28 per cent. Gains in respect of which entrepreneurs' relief is claimed, which are taxable at 10 per cent (see paragraph 13 below), are set against any unused amount of the basic rate band before other gains.

9. New section 4A supplements section 4 in cases where income tax liability is reduced by reason of certain reliefs in relation to life insurance policies, capital redemption policies and contracts for life annuities, or certain income of the estates of deceased persons. It ensures that these reliefs are taken into account in determining any unused amount of the basic rate band. Section 4A is modelled on, and has the same effect as, the old section 6 of TCGA which applied for tax years before 2008-09 when the rate of CGT was linked to income tax liability.

10. The revised section 4 and the new section 4A have effect for gains arising on or after 23 June 2010 (paragraph 12).

11. Paragraph 3 of the Schedule inserts a new section 4B into the TCGA. This section provides that a person whose gains for a tax year are chargeable to CGT at more than one rate may deduct any allowable losses and the annual exempt amount for that year in the way that produces the lowest possible tax charge. Existing legislation that limits the way certain losses may be set off continues to apply. New section 4B has effect for the year 2010-11 and later years (paragraph 13).

12. Paragraphs 4 to 8 amend the provisions of the TCGA that provide the rules for entrepreneurs' relief. Entrepreneurs' relief reduces the effective rate at which gains on disposals of certain assets are charged to CGT. There are two main changes. First, from 23 June 2010 entrepreneurs' relief is given by charging qualifying gains at a reduced rate of 10 per cent, whereas before that date the relief was given by reducing the amount of qualifying gains charged at the single rate of CGT prevailing at that time. Second, the lifetime limit on the gains eligible for relief is increased from £2 million to £5 million.

13. Paragraph 4 amends the description of entrepreneurs' relief in the introductory section 169H, to reflect the change in the way the relief is given.

14. Paragraph 5 amends section 169N of TCGA, which provides the mechanism for giving entrepreneurs' relief. The effect of the changes is that from 23 June 2010 gains in respect of which entrepreneurs' relief is claimed are charged at 10 per cent, up to an increased lifetime limit of gains of £5 million. Gains arising before 23 June 2010 that benefited from entrepreneurs' relief are taken into account in determining whether the lifetime limit has been reached.

15. Paragraphs 6 and 7 amend sections 169O and 169P of TCGA, to remove references to the reduction of the gain made under the previous rules for entrepreneurs' relief.

16. The changes made by paragraphs 4 to 7 of the Schedule have effect for disposals on or after 23 June 2010 (paragraph 14).

17. Paragraph 8 substitutes a new section 169R in TCGA. That section applies where shares are exchanged for qualifying corporate bonds (QCBs) (for example, on the takeover of a company) and a gain on disposal of the shares could have qualified for entrepreneurs' relief. QCBs are exempt from CGT. The main CGT legislation provides that the exchange is not treated as a disposal of the shares. Instead, a gain is calculated as though the exchange were a disposal, and comes into charge when there is a disposal of the QCBs.

18. Section 169R, as it stood before these changes, applied if a gain on the disposal of the shares at the time of the exchange could qualify for entrepreneurs' relief. It had the effect that, if a claim was made, then in computing the deferred gain that comes into charge on disposal of the QCBs, the deduction of 4/9 that gave the effective lower rate for entrepreneurs' relief should be taken into account, so that entrepreneurs' relief was effectively given.

19. The changes made by paragraph 8 have the effect that, if entrepreneurs' relief would be available on a disposal of the shares at the time of the exchange for QCBs, an election can be made for the gain not to be deferred but instead brought into charge at that time and the relief claimed. If no election is made and the gain is therefore deferred, it is likely that in almost all cases the gain will not qualify for entrepreneurs' relief when it comes into charge at a later date. The new rule has effect where the exchange of shares for QCBs takes place on or after 23 June 2010 (paragraph 15).

20. Paragraph 9 applies where an individual's gain on a disposal could qualify for entrepreneurs' relief and could be deferred because the individual invests, within a specified time limit, in shares qualifying under the Enterprise Investment Scheme ("EIS shares"). The deferred gain comes back into charge on the occurrence of any of a number of "chargeable events" (such as a disposal of the EIS shares). Under the entrepreneurs' relief rules as they stood before these changes, it was possible for a claim for entrepreneurs' relief to be made in respect of the gain, so that it was reduced by 4/9, and then for that reduced gain to be deferred against investment in EIS shares and come back into charge on the occurrence of a chargeable event.

21. Paragraph 9 modifies the rules for EIS relief following the change to the way in which entrepreneurs' relief is given. In future an individual may choose between claiming entrepreneurs' relief and paying tax on the gain at 10 per cent, or deferring the gain under the EIS rules and paying tax at 18 per cent or 28 per cent when it later comes into charge. Where a gain exceeds the £5 million lifetime limit for entrepreneurs' relief it will be possible to claim entrepreneurs' relief on the gain up to the limit and to defer the gain above the limit under the EIS rules. This change has effect where the gain arises on a disposal on or after 23 June 2010 (paragraph 14).

Amendments to Finance Act (FA) 2008

22. When entrepreneurs' relief was introduced in FA 2008 there were a number of transitional provisions which enabled entrepreneurs' relief to be claimed in respect of certain deferred gains that arose before 6 April 2008. In relation to both gains deferred as a result of an exchange of shares for loan notes, and gains deferred by investment in EIS shares or shares in a venture capital trust (VCT shares), it was possible to claim entrepreneurs' relief on the first occasion on or after 6 April 2008 when all or part of the deferred gain came into charge. Where such a claim was made, the whole of the deferred gain that had not come in to charge before 6 April 2008 was reduced by 4/9.

23. Paragraphs 10 and 11 amend those transitional provisions following the change to the way in which entrepreneurs' relief is given. They have effect in cases where none of the gains deferred as at 6 April 2008 has come into charge between 6 April 2008 and 22 June 2010, so that no claim for entrepreneurs' relief can have been made in respect of those gains.

24. Paragraph 10 applies where gains were deferred before 6 April 2008 in respect of an exchange of shares for QCBs. When any part of the deferred gain comes into charge on or after 23 June 2010, because of a disposal of all or some of the QCBs at that time, a claim for entrepreneurs' relief in respect of the deferred gain can be made under the transitional provisions in Schedule 3 to FA 2008. Where such a claim is made (and the other conditions for the relief were satisfied at the time of the exchange), the deferred gains are charged at the entrepreneurs' relief rate of 10 per cent. This revised rule applies where the first disposal of QCBs since 6 April 2008 takes place on or after 23 June 2010 (paragraph 16).

25. Paragraph 11 applies where gains arising before 6 April 2008 were deferred against investment in EIS shares or VCT shares. Where all or part of that gain comes into charge on or after 23 June 2010 because a "chargeable event" (see paragraph 19 above) takes place on or after that date, a claim for entrepreneurs' relief in respect of the deferred gain may be made under the transitional provisions of Schedule 3 to FA 2008. Where such a claim is made (and the other conditions for the relief were satisfied at the time the gain arose), the deferred gain is charged at the entrepreneurs' relief rate of 10 per cent. This revised rule applies where the first chargeable event since 6 April 2008 takes place on or after 23 June 2010 (paragraph 17).

26. If a claim under the FA 2008 transitional rules has been made because a disposal of QCBs (in relation to the rules in respect of exchanges of shares for QCBs) or a chargeable event (in relation to a deferral against investment in EIS shares or VCT shares) took place between 6 April 2008 and 22 June 2010, any part of the deferred gain that qualified for entrepreneurs' relief and has not come into charge before 23 June 2010 will have been reduced by 4/9. When that reduced gain comes into charge on or after 23 June 2010, the reduced gain will be charged at the "new" rate of 18 per cent or 28 per cent.

Transitional provisions

27. Paragraphs 18 to 22 provide transitional rules for certain cases affected by the alteration in the rates of CGT part-way into the year 2010-11.

28. Paragraph 18 ensures that for 2010-11 gains arising before 23 June 2010 are charged at the single 18 per cent rate that applied before that date, and are not taken into account in determining which gains arising on or after 23 June 2010 are set against any unused amount of the income tax basic rate band.

29. Paragraph 19 provides a rule in relation to section 10A of TCGA. Section 10A provides that, where an individual ceases to be resident in the UK and then resumes residence within a specified time, certain gains that they realised during the period of non-residence are treated as arising in the year they again become resident. Where the resumption of residence is during 2010-11, all gains arising under section 10A are treated as arising before 23 June 2010, and are therefore chargeable at the single rate of 18 per cent.

30. Paragraph 20 provides a rule for individuals who are taxed on the "remittance basis". This basis is available to individuals who are resident in the UK but are not domiciled here. One aspect of the remittance basis is that gains on the disposal of assets situated outside the UK are chargeable only when they are remitted (brought into) the UK.

31. Paragraph 20(1) provides that for individuals taxed on the remittance basis for 2010-11, gains remitted to the UK are treated as arising at the time they are remitted (so that the time of remittance determines whether the gains are treated as arising before 23 June 2010 or on or after that date). The provision is subject to sub-paragraph (2).

32. Paragraph 20(2) addresses the case where section 809J of the Income Tax Act 2007 applies so that a remittance is not treated as a remittance of the actual income or gains being remitted, but instead is treated as a remittance of other income or gains in accordance with a special rule. This can occur if an individual who elects for remittance

basis has to pay a "remittance basis charge" of £30,000. Any gains treated under section 809J as remitted during 2010-11 are deemed to arise before 23 June 2010, so that they are chargeable at the single rate of 18 per cent.

33. Paragraph 21 deals with cases where section 86 of TCGA applies. Section 86 applies in cases where the trustees of a settlement are not resident in the UK, and the settlor of the settlement is resident and domiciled in the UK and has an interest in the settled property. The effect of section 86 is that the trustees' gains of the year (net of losses) are effectively charged on the settlor. Paragraph 21 has the effect that where section 86 applies for 2010-11, all the gains chargeable on the settlor by virtue of that section are treated as arising before 23 June 2010, so that they are chargeable at the single rate of 18 per cent.

34. Paragraph 22 applies where trustees of a settlement are not resident in the UK and their gains are effectively charged on UK-resident beneficiaries who receive capital payments from the trust. The amount of such a charge is determined by "matching" capital payments received with trustees' gains (net of losses). Paragraph 22 has the effect that where the receipt of capital payments in 2010-11 results in gains being charged to beneficiaries for that year, the gains matched with each capital payment are treated as arising when the capital payment was received. So gains matched with capital payments received between 6 April and 22 June 2010 will be chargeable at the single rate of 18 per cent, while gains matched with capital payments received on or after 23 June 2010 will be chargeable at 18 per cent or 28 per cent, dependent upon how much of the beneficiary's income tax basic rate band is unused.

Background Note

35. Since 6 April 2008 capital gains tax has been charged at a single rate of 18 per cent. Gains in respect of which entrepreneurs' relief is claimed have been taxed at an effective rate of 10 per cent (up to a lifetime limit of qualifying gains of £1 million, increased to £2 million with effect from 6 April 2010). This effective 10 per cent rate was given effect by reducing qualifying gains by 4/9 and charging the balance at the single 18 per cent rate.

36. The changes made by Schedule 1 replace this single 18 per cent rate of CGT with effect from 23 June 2010.

37. Gains qualifying for entrepreneurs' relief will be charged at a new 10 per cent rate, instead of being reduced by 4/9 and charged at 18 per cent, and the lifetime limit on total gains eligible for relief is increased from £2 million to £5 million.

38. For individuals, the rate at which gains, other than gains qualifying for entrepreneurs' relief, are charged will depend upon the individual's top rate of income tax for the year. If an individual's taxable income is lower than the maximum of their basic rate band, gains up to the amount of the shortfall are charged at 18 per cent. Any other gains of individuals are charged at 28 per cent.

39. Gains of trustees of settlements and personal representatives of deceased persons are charged at 28 per cent.

40. Because different gains may be charged at different rates of CGT, there is a new rule that losses and the annual exempt amount (AEA) are deductible from gains in the order that gives the best result for the taxpayer. This will normally mean that losses and the AEA are deducted first from the gains potentially liable at the highest rate.

41. Because the changes to the rates of CGT take effect part of the way though the tax year 2010-11, gains arising between 6 April 2010 and 22 June 2010 are chargeable under the old rules at 18 per cent, with gains qualifying for entrepreneurs' relief being reduced by 4/9 before being charged. Gains arising on or after 23 June 2010 are charged under the new rules, as explained at paragraphs 36 to 39 above.

42. The rule for deduction of losses described at paragraph 39 will apply to all gains of the year 2010-11. This will normally involve losses and the AEA being deducted:

- first from gains (other than gains qualifying for entrepreneurs' relief) arising on or after 23 June 2010, that are chargeable at 28 per cent or 18 per cent;
- then from gains arising between 6 April 2010 and 22 June 2010 (including gains qualifying for entrepreneurs' relief that have been reduced by 4/9), that are chargeable at the previous single 18 per cent rate; and
- finally from gains arising on or after 23 June 2010 that qualify for entrepreneurs' relief and are chargeable at the new 10 per cent rate.

Section 3Schedule 2: Vat: Increase in Standard Rate and Anti-Avoidance Provision

Summary

1. Section 3 provides for the standard rate of VAT to increase to 20 per cent on 4 January 2011. Section 3 and Schedule 2 introduce a supplementary charge to VAT of 2.5 per cent on certain supplies that span the date on which the standard rate of VAT changes from 17.5 per cent to 20 per cent.

Details of the Section

2. Subsection (1) amends section 2(1) of the VAT Act 1994 (VATA) to increase the standard rate of VAT from 17.5 per cent to 20 per cent.

3. Subsection (2) substitutes in section 21(4) of VATA 25 per cent for 28.58 per cent. This preserves the effective 5 per cent VAT rate on imports of goods defined in section 21(5) of VATA (works of art, certain antiques, collections and collector's pieces).

4. Subsection (3) provides for the amendment in subsection (1) to have effect in relation to any supply made on or after 4 January 2011 and any acquisition or importation taking place on or after that date.

5. Subsection (4) provides for the amendment made by subsection (2) to have effect in relation to goods imported on or after 4 January 2011.

Details of the Schedule

6. Paragraph 1 introduces a supplementary charge to VAT on supplies of goods and services, subject to the standard rate of VAT, which take place on or after 22 June 2010. The supplementary charge is payable where:

- the supply spans the date on which the standard rate increases to 20 per cent (4 January 2011 – the "date of the VAT change");
- the customer is not entitled to recover all of the VAT on the supply; and
- at least one of the relevant conditions laid down in paragraphs 2 or 3 is met.

7. Paragraph 2 provides that a supply of goods or services (other than a grant covered by paragraph 3) spans the date of the VAT change where the supplier raises a VAT invoice or receives payment (or both) prior to the VAT rate change and the basic time of supply takes place on or after the date of the change.

8. The supplementary charge will apply where at least one of the following relevant conditions is met:

- Condition A - the supplier and the customer are connected with each other at any time during the period from the date of the supply to the date of the VAT change;

- Condition B - the relevant consideration for the supply and any related supply of goods or services amounts to more than £100,000;
- Condition C - the supplier or a person connected with him finances a prepayment by the customer; and
- Condition D - the supplier raises a VAT invoice where payment is not due until at least six months from the date of the invoice.

9. Paragraph 3 applies to the supply of the grant of a right to receive goods or services at a discount or free of charge where the grant is supplied before the date of the VAT change but the basic time of supply of some or all of the goods or services takes place on or after that date. A right for this purpose includes an option or an interest deriving from a right (or option). The supplementary charge will apply where at least one of the following relevant conditions is met:

   - Condition A - the grantor and the customer are connected with each other at any time during the period from the date of the supply to the date of the VAT change;
   - Condition B - the relevant consideration for the grant of the right and any related supply of goods or services amounts to more than £100,000; and
   - Condition C - the supplier or a person connected with him finances the customer's payment for the grant of the right.

10. Paragraph 4 defines the basic time of supply by reference to section 6 of VATA, as the time that goods are delivered or made available, or that services are performed. This is subject to a special rule for listed supplies in paragraphs 18 and 19 of this Schedule.

11. Paragraph 5 extends the connected persons condition in paragraphs 2 and 3. It applies where there is a series of supplies of, or a series of grants of, the right to receive, the same or substantially the same, goods or services. In these circumstances, if any supplier or grantor in the series is connected to the customer, the supplementary charge will apply to the supply to the customer.

12. Paragraph 6 defines "relevant consideration" and "related" supply for the purpose of Condition B in paragraphs 2 and 3.

13. Relevant consideration in relation to the supply of goods or services consists of the amount shown on a VAT invoice or the amount of payment received. Relevant consideration in relation to the grant of a right consists of the consideration for the grant of the right. In all cases it is net of VAT.

14. A supply of goods or services or a grant of a right is related to another such supply or grant where they are both made as part of the same scheme. "Scheme" includes any arrangements, transaction or series of transactions.

15. Paragraph 7 sets out the circumstances in which a supplier or a person connected with the supplier is treated as financing the payment for a supply of goods or services or the grant of a right to receive goods or services, for the purposes of condition C in paragraphs 2 and 3.

16. Paragraph 8 provides that section 1122 of the Corporation Tax Act 2010 applies for the purpose of defining "connected persons". Individuals are connected to spouses or civil partners, certain relatives, persons with whom they are in partnership, and companies they control (on their own or in conjunction with other persons). Companies are connected to other companies under the same control. Trustees are connected with trust settlors (if individuals) and close companies controlled by the trust.

17. Paragraph 9 provides that receipt of payment by a supplier includes receipt of payment by a person to whom the right to receive that payment has been assigned.

18. Paragraph 10 provides powers for HM Treasury to amend the relevant conditions and make other incidental or consequential amendments to the Schedule by order.

19. Paragraph 11 provides for exceptions to the application of the supplementary charge. Where a supply consists of the lease, hire or rent of any asset, a supplementary charge will not apply if the VAT invoice or payment covers a period of up to one year and this accords with normal commercial practice, as defined in paragraph 14.

20. Paragraph 12 provides that the supplementary charge will not apply to a supply that meets only condition B in paragraph 2 or 3, if it is made in accordance with normal commercial practice.

21. Paragraph 13 provides that the supplementary charge will not apply to a supply that meets only condition D in paragraph 2, if the VAT invoice relates to hire purchase, conditional sale or credit sale of goods, and the basic time of supply is intended or expected to be within six months of the VAT invoice.

22. Paragraph 14 defines "normal commercial practice".

23. Paragraph 15 provides powers for HM Treasury to introduce further exceptions to the application of the supplementary charge by order. Such exceptions may remove supplementary charges falling before or after the order comes into effect, if the supplies concerned were made at any time from 22 June 2010 onwards.

24. Paragraph 16 provides that the supplier of, or the grantor of a right to receive, goods or services is liable to account for the supplementary charge. Where the supplier or grantor is a member of a VAT group, the representative member of that group is liable to account for it. In the case of goods and services, payment is due on the date of the VAT change. In the case of the grant of a right covered by paragraph 3, payment is due on the date that the right is first exercised on or after the date of the VAT change.

25. Paragraph 17 provides that the rate of the supplementary charge is the difference between the VAT charged on the supply of goods or services or of a grant (i.e. 17.5 per cent) and the rate in force after the rate change (i.e. 20 per cent).

26. Paragraphs 17(3)-(4) provide that where, under the terms of a grant of a right, some goods or services are supplied before the rate change and some are supplied after it, the consideration should be apportioned to ascertain the amount that is properly subject to the supplementary charge.

27. Paragraph 18(1) defines a "listed supply", for the purposes of the Schedule, as ones which are:

    - listed in paragraph 18(2); and
    - are supplies of goods or services where payment is made periodically or from time to time and which are treated as having taken place by virtue of either the issue of a VAT invoice by the supplier or receipt of payment.

28. Paragraph 18(3) provides powers for HM Treasury to amend the list by order.

29. Paragraph 19 provides that, for the purposes of listed supplies in paragraph 18, the basic time of supply occurs at the end of the period for which a VAT invoice is raised or payment is received.

30. However, under paragraph 19(2), where a supplier has raised a VAT invoice or received payment in respect of a listed supply which is still continuing and issues an invoice for a "billing period" that ends before the end of the period covered by the VAT invoice or payment, the end of the billing period becomes the basic time of supply for that part of the supply. In such cases, paragraph 19(3) provides that the consideration for the listed supply must be apportioned between the periods on a just and reasonable basis.

31. Paragraph 19(4) provides that, where a listed supply arises in relation to a premium for the grant of a tenancy or a lease, the basic time of supply is the date of the grant.

32. Paragraph 20 provides that, where a person is required to account for a supplementary charge but deregisters for VAT before the supplementary charge becomes payable, he is required to account for it in his final return. However, any interest that arises on an assessment in relation to the supplementary charge will run from the date when the supplementary charge is due rather than the date when the final return is due.

33. Paragraph 21 provides for adjustment of contracts where a contract is made for the supply of goods or services before the rate change and a supplementary charge is due on the supply. In such cases, unless the contract provides otherwise, the consideration due under the contract will be increased by the amount of any supplementary charge.

34. Paragraph 22 permits HM Revenue & Customs to make regulations concerning the provision, replacement or correction of VAT invoices when a supplementary charge applies, to ensure that the supplier and customer correctly account for VAT.

35. Paragraph 23 provides that orders made under the provisions of the Schedule are subject to the negative resolution procedure apart from those made (at least in part) under paragraph 10 which extend the scope of the supplementary charge, which require House of Commons approval within 28 days of being made.

Background Note

36. In his Budget Statement of 22 June 2010, the Chancellor announced an increase in the standard rate of VAT from 17.5 per cent to 20 per cent. On 22 June 2010 the Exchequer Secretary to the Treasury, in a Written Ministerial Statement, explained that the Government would introduce anti-forestalling legislation to prevent artificial avoidance seeking to exploit the change in VAT rate. The statement can be seen at www.hmrc.gov.uk

Section 4: Rate of Insurance Premium Tax

Summary

1. Section 4 increases the standard rate of insurance premium tax (IPT) from 5 per cent to 6 per cent and the higher rate of IPT from 17.5 per cent to 20 per cent, both with effect from 4 January 2011.

Details of the Section

2. Section 51(2)(a) of the Finance Act (FA) 1994 provides that the higher rate of IPT is 17.5 per cent, and section 51(2)(b) of FA 1994 provides that the standard rate of IPT is 5 per cent.

3. Subsection (1)(a) of the section substitutes 20 per cent for 17.5 per cent, and subsection (1)(b) substitutes 6 per cent for 5 per cent.

4. Subsection (2) applies the new rates to insurance premiums which fall to be regarded as received by insurers under taxable insurance contracts on or after 4 January 2011.

5. Subsection (3) makes consequential changes in relation to the application of anti-avoidance measures contained in sections 67A and 67C of FA 1994, relating to avoidance in the period between the announcement and implementation of rate rises. For the purposes of these provisions:

- the date of announcement of the increase in rate is 22 June 2010; and
- the date of change is 4 January 2011.

6. Subsection (4) repeals section 125 of FA 1999 which introduced the current 5 per cent standard rate of IPT.

Background Note

7. Insurers use one of two methods to calculate their IPT liability by reference to the date on which the premiums are received by them. These are:

   - the cash receipt method, which uses the date when the insurer, or someone acting on their behalf, physically receives the premium payment; or
   - the special accounting scheme or premium written method, which uses the date when the insurer records the premium as being due to them.

8. There are anti-avoidance measures which help to (a) prevent insurers from adding additional or new risks to existing contracts and (b) prevent insurance contracts being paid for or extended in advance of the increases in the rates of IPT announced on 22 June 2010 coming into effect, thereby avoiding the increase in tax.

Section 5: Power to Repeal High Income Excess Relief Charge

Summary

1. Section 5 gives HM Treasury a power to make an order repealing section 23 of and Schedule 2 to the Finance Act (FA) 2010. Section 23 and Schedule 2 to FA 2010 introduced, with effect from 6 April 2011, a restriction of pension tax relief to the basic rate for high income individuals, known as the "high income excess relief charge".

Details of the Section

2. Subsection (1) provides that HM Treasury may make an order to repeal section 23 of and Schedule 2 to FA 2010 so that the high income excess relief charge is not introduced.

3. Subsection (2) provides that any order under subsection (1) must be made on or before 31 December 2010.

4. Subsection (3) provides that any order under subsection (1) is excluded from the provisions of section 1014 of the Income and Taxes Act 2007 (ITA). Section 1014 of ITA would have provided for the negative resolution procedure to apply to a statutory instrument made under the section.

Background Note

5. Section 23 of and Schedule 2 to FA 2010 restrict tax relief for pension contributions made by or for the benefit of high income individuals. The charge, known as the high income excess relief charge, is on pension contributions for individuals whose gross income is £150,000 or more and whose relevant income is £130,000 or more.

6. Under Schedule 2 to FA 2010, the high income excess relief charge will come into force with effect from 6 April 2011.

7. In the Emergency Budget 2010, the Chancellor announced that the Government believes that the approach legislated for in Finance Act 2010 could have unwelcome consequences for pension saving, bring significant complexity to the tax system, and damage UK business and competitiveness. An alternative approach involving reform of the existing allowances, principally of a significantly reduced annual allowance, might better meet the Government's objectives. The Government wishes to engage employers, pension schemes, experts and other interested parties to determine the best design of a regime.

8. This power in this section allows the Government to repeal the legislation relating to the high income excess relief charge at any time before 31 December 2010.

9. The Government will repeal this legislation once it has decided the detail of its approach.

Section 6Schedule 3: Pensions: Treatment of Persons at Age 75

Summary

1. Section 6 and Schedule 3 modify how certain tax rules relating to registered pension schemes apply to individuals reaching age 75 on or after 22 June 2010. The changes apply to individuals with money purchase arrangements who reach age 75 without having used their pension fund to purchase an annuity or otherwise secure a pension income. On reaching age 75 these individuals will remain, or become, subject to the same rules about both the income they may withdraw and the lump sum death benefits that may be paid from income withdrawal arrangements as previously applied only up to age 75. The limits and charges instead continue to apply until the individual's 77th birthday. The inheritance tax charges specifically applying to pension scheme members aged 75 or over consequently will not apply in relation to individuals until they reach age 77 provided their 75th birthday was on or after 22 June 2010. The Section and Schedule enable those reaching age 75 on or after 22 June 2010 to defer their decision on what to do with their pension savings until after the new rules announced by the Government are finalised next year.

Details of the Schedule

2. Paragraph 1 of Schedule 3 provides that the changes made by the Schedule will apply only to persons whose 75th birthday occurs on or after 22 June 2010.

3. Sub-paragraph (1) of paragraph 2 modifies how certain tax rules in Part 4 of the Finance Act (FA) 2004 apply to the persons to whom the Schedule applies by virtue of paragraph 1. It provides that the tax rules listed in sub-paragraph (2), which otherwise would have effect when the member or dependant of a registered pension scheme reaches age 75, do not apply until the member or dependant reaches the age of 77. Part 4 of FA 2004 contains the tax rules relating to registered pension schemes.

4. Sub-paragraph (2) of paragraph 2 lists the provisions in FA 2004 whose effect is modified by sub-paragraph (1). These modifications provide that:

   - an unsecured pension may be paid as an authorised pension to a member or dependant until their 77th birthday;
   - an alternatively secured pension fund is not created until a member's or dependant's 77th birthday; and
   - an unsecured pension lump sum death benefit may be paid until the member's or dependant's 77th birthday.

5. Paragraph 3 provides that when a person, to whom this schedule applies:

   - receives an unsecured pension in the form of a short-term annuity; and
   - that short-term annuity was purchased on or after 22 June 2010,

   the term of the short-term annuity may continue until the person's 77th birthday.

6. Where this Schedule applies to an untraceable scheme member, Paragraph 4 provides that the special rules suspending the application of the alternatively secured pension will not apply unless the person's whereabouts are not known to the scheme administrator when the person reaches the age of 77.

7. Paragraph 5 applies when a scheme member, to whom the Schedule applies, reaches the age of 75 and at that time there are uncrystallised funds held for the purposes of an arrangement relating to that individual. Funds are uncrystallised if they have not yet

been used to provide a scheme pension, a lifetime annuity or an unsecured pension. Paragraph 5 provides that the amounts designated as available to pay an unsecured pension by virtue of paragraph 8(2) of Schedule 28 to FA 2004 exclude any lump sum that the member becomes entitled to under the scheme rules as a consequence of that designation. As a result of the changes effected by paragraphs 2 to 4, the designated funds (excluding the lump sum entitlement) will form part of the member's unsecured pension fund from age 75 until age 77. The designation of these funds as available to pay an unsecured pension is a benefit crystallisation event under section 216 of FA 2004 for the purposes of determining whether the member has a liability to the lifetime allowance charge. Where the value of a member's pension benefits exceeds the lifetime allowance (set at £1.8 million for the 2010-2011 tax year), the excess is subject to the lifetime allowance charge at a rate of 55 per cent (on lump sums drawn) or 25 per cent (where income benefits are taken).

8. Sub-paragraph (1) of paragraph 6 provides that despite paragraph 5 the amount of the lump sum to which a member becomes entitled as described in paragraph 5 is treated for the purposes of the lifetime allowance charge as if that amount had in fact been designated as available to pay an unsecured pension immediately before the member reached the age of 75. This means that the amount of the benefit crystallisation event that occurs immediately before the member's 75th birthday by virtue of the operation of paragraph 8(2) of Schedule 28 to FA 2004 takes into account all of the uncrystallised funds at that time, whether available to be used to pay income withdrawal or held back to pay a pension commencement lump sum.

9. Sub-paragraph (2) of paragraph 6 consequently provides that there are no implications relating to the lifetime allowance charge when or if the lump sum is physically paid to or in respect of the member. This is because the value of the lump sum has already been taken into account for the purposes of the lifetime allowance charge by virtue of sub-paragraph (1) and so prevents any double-counting of the value for the purposes of the lifetime allowance charge.

10. Paragraph 7 provides that the provision in paragraph 1(3)(b) of Schedule 29 to FA 2004 (which prevents a lump sum entitlement to which arise by virtue of the operation of paragraph 8(2) of Schedule 29 to FA 2004, from being a pension commencement lump sum) does not apply to the lump sum described in paragraph 5 provided all of the other conditions applicable to pension commencement lump sums are satisfied. One of the conditions that a lump sum must meet in order for it to be a pension commencement lump sum is that it is paid within one year of the person becoming entitled to a pension in connection with which the lump sum is paid. It is consequently not always possible to determine whether a lump sum is a pension commencement lump sum until after it has been paid. A pension commencement lump sum also may only be paid to a member while they are still living. A pension commencement lump sum is not liable to income tax.

11. Sub-paragraph (1) of paragraph 8 provides that if a year after the member's 75th birthday there are still funds held for the purposes of the arrangement that have:

- neither been designated as available to pay an unsecured pension;
- nor paid as a lump sum;
- nor applied towards the provision of a scheme pension or a dependants' scheme pension,

these funds are treated as if they are designated as available for payment of unsecured pension and added to the unsecured pension fund at that time. They consequently become available to pay out as an unsecured pension fund lump sum death benefit if the member should subsequently die. An unsecured pension fund lump sum death benefit is liable to tax at a rate of 35 per cent in accordance with section 206 of FA 2004.

12. Sub-paragraph (2) of paragraph 8 provides that if the member dies before a year has passed since the member's 75th birthday and at the date of death there are still funds held for the purposes of the arrangement that have:

- neither been designated as available to pay an unsecured pension;
- nor paid as a lump sum;
- nor applied towards the provision of a scheme pension or a dependants' scheme pension,

these funds are treated as if they have been designated as available for payment of unsecured pension immediately before the member's death. This means that the fund is available to be paid out as an unsecured pension fund lump sum death benefit by reason of the member's death. An unsecured pension fund lump sum death benefit is liable to tax at a rate of 35 per cent in accordance with section 206 of FA 2004.

13. Sub-paragraph (3) of paragraph 8 defines "remaining uncrystallised funds" for the purposes of sub-paragraphs (1) and (2).

14. Sub-paragraphs (1) and (2) of paragraph 9 operate when the rules of the registered pension scheme are framed in such a way as to prevent the scheme from making certain payments to a member or dependant, who has reached the age of 75 on or after 22 June 2010 but has not yet reached the age of 77. It enables the Trustee or Manager of the scheme to make payments to or in respect of such persons, which may be paid as authorised payments only by virtue of paragraphs 2 to 4, without first having to change the Scheme rules.

15. Sub-paragraph (3) of paragraph 9 provides that trustees or managers of a registered pension scheme have discretion to confer entitlement to a lump sum on a member, in respect of whom paragraph 8(2) of Schedule 28 to FA 2004 has operated to deem there to have been a designation of funds as available to pay an unsecured pension, whether or not the scheme rules confer such an entitlement.

16. Paragraph 10 provides that any terms used both in Part 4 of FA 2004 and in this Schedule have the same meaning in the Schedule as they do in Part 4.

Background Note.

17. The Government announced in paragraph 1.117 of the Budget document (June 2010) that "it will end the existing rules that create an effective obligation to purchase an annuity by age 75 from April 2011 to enable individuals to make more flexible use of their pension savings. The Government will shortly launch a consultation on the detail of this change."

18. This change will also apply for the purposes of the inheritance tax (IHT) charges that specifically apply to pension scheme members aged 75 and over.

19. Those specific IHT charges, included in sections 151A-151C of the Inheritance Tax Act 1984 (IHTA), are linked in to the pension tax rules and the definition of the different pension benefits. This means that once changes are made to the definition of an alternatively secured pension in Schedule 28 to FA 2004 so that it applies only from age 77 onwards, this automatically follows through for the purpose of these IHT provisions.

20. The changes do not however follow though for the purpose of the anti-avoidance provisions at section 151D of IHTA. These charges are triggered by an unauthorised payment charge and unlike the charges on alternatively secured pension funds do not apply automatically when a scheme member dies. The changes made by this Section and Schedule also leaves the prospect of a charge to IHT under section 3(3) of IHTA where the member of a registered pension scheme has reached age 75 and dies having

deliberately omitted to take his retirement benefits so that the death benefits can pass to his chosen beneficiaries.

Section 7Schedule 4: Expenses Paid to Mps Etc

Summary

1. Section 7 introduces Schedule 4. This Schedule provides for the exemption from income tax of certain expenses paid or reimbursed to MPs following the introduction, by the Independent Parliamentary Standards Authority (IPSA), of a new scheme for paying the expenses of Members of Parliament (MPs). This will broadly have the effect of maintaining the tax treatment that applied to similar expenses paid under the previous arrangements for reimbursing MPs' expenses.

Details of the Schedule

2. Paragraph 1(2) substitutes a new section 292 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA), exempting from tax certain payments made by IPSA to MPs in respect of their accommodation expenses. The new section 292 reflects the position that, with effect from 7 May 2010, expenses paid to MPs are no longer paid under a resolution of the House of Commons but instead under the scheme administered by IPSA made under the Parliamentary Standards Act 2009 (PSA).

3. Subsection (1) of the new section 292 provides for payments made by IPSA under section 5(1) of PSA to be exempt from income tax if they are expressed to be made in respect of accommodation expenses, or if they are related to or in consequence of a payment of accommodation expenses. The latter condition ensures that payments made by IPSA which are related to accommodation expenses, such as the additional payments made to MPs who claim accommodation expenses for a rental property and who have caring responsibilities, are within the scope of the exemption.

4. New subsection (2) defines "accommodation expenses" for the purpose of new subsection (1).

5. New subsections (3) and (4) provide that particular payments made under IPSA's scheme in relation to overnight accommodation are not within the scope of the income tax exemption for accommodation expenses.

6. New subsection (3) provides that expenses reimbursed by IPSA for the cost of an overnight stay in a hotel, which has been incurred only because the MP was required to attend a late night sitting of the House of Commons, does not fall within the meaning of "accommodation expenses" for the purpose of new subsection (1) unless the House has sat beyond 1 a.m. Where the cost of an overnight stay in a hotel is reimbursed by IPSA because the MP was required to attend a sitting of the House beyond 1 a.m. and IPSA have agreed that it would not be reasonable for the MP to return to any residence, the exemption provided by subsection (1) will apply.

7. New subsection (4) provides that loans advanced to MPs for a deposit on a rental property do not fall within the meaning of "accommodation expenses" for the purposes of new subsection (1).

8. Paragraph 1(3) amends section 360 of ITEPA to take account of the new section 292.

9. Paragraph 1(4) provides for the new section 292 of ITEPA to have retrospective effect so that the tax exemption it provides applies in relation to payments made to MPs by IPSA on or after 7 May 2010, being the start of the current Parliament.

10. Paragraph 1(5) provides for any expenses that remain payable on or after 7 May 2010 under the arrangements in place prior to that date to be subject to ITEPA as if it had not been amended by this Schedule.

11. Paragraph 1(6) provides that the amendment to section 360 of ITEPA applies only in relation to expenses incurred by MPs on or after 7 May 2010.

12. Paragraph 2(1) inserts new section 293A into ITEPA.

13. New section 293A(1) provides for payments made by IPSA under section 5(1) of the PSA in respect of relevant UK travel and relevant subsistence expenses to be exempt from income tax. "Relevant UK travel expenses" and "relevant subsistence payments" are defined in subsections (2) and (3) of new section 293A(1). Subsection (4) provides further definitions for the purposes of subsection (2). These definitions rely on IPSA's scheme under section 5 of the PSA and subsection (4) of section 293A expressly provides that if IPSA changes the definitions for the purposes of its scheme, they will also change for the purposes of subsection (2) of new section 293A.

14. Paragraph 2(2) provides that new section 293A has effect in relation to payments made by IPSA on or after 7 May 2010.

15. Paragraph 2(3) provides for any expenses that remain payable on or after 7 May 2010 under the arrangements in place prior to that date to be subject to ITEPA as if it had not been amended by this Schedule.

16. Paragraph 3 amends section 294 of ITEPA in respect of European travel expenses incurred by MPs and members of the devolved administrations.

17. Paragraph 3(2) substitutes a new subsection (1) of section 294 which consolidates the previous provisions and reflects the fact that European travel expenses incurred by MPs are no longer paid or reimbursed in accordance with a resolution of the House of Commons but instead are paid by IPSA under section 5(1) of the PSA.

18. Paragraph 3(3) amends subsection (3)(b)(iii) of section 294 to extend the definition of "relevant European location" for the purposes of the tax exemption in that section to include countries which are members of the Council of Europe. This reflects the expenses payments that IPSA will make to MPs, but the extended tax exemption will also apply to members of the devolved administrations if equivalent expenses payments are made to them under their respective expenses schemes.

19. Paragraph 3(4) provides that the amendments to section 294 of ITEPA have effect in relation to expenses payments made to MPs and members of the devolved administrations on or after 7 May 2010.

20. Paragraph 3(5) provides for any expenses that remain payable to MPs on or after 7 May 2010 under the arrangements in place prior to that date to be subject to ITEPA as if it had not been amended by this Schedule.

Background Note

21. Under the PSA, IPSA has developed a new scheme under which MPs have been paid their expenses since the Parliamentary election on 6 May 2010.

22. Prior to the establishment of IPSA, expenses were reimbursed in accordance with resolutions of the House of Commons and the tax treatment of particular expenses was determined by specific legislation for MPs in relation to some expenses and long standing concessions in relation to travel expenses. The advent of IPSA means that the specific tax legislation needs amending, and at the same time past concessionary treatments need to be formalised in legislation or ended.

23. Section 292 of ITEPA exempts from income tax accommodation expenditure that was paid to MPs in respect of additional expenses necessarily incurred in staying overnight away from their only or main home for the purpose of performing their Parliamentary duties. The current wording of the exemption reflects the fact that payments of these expenses were made under a resolution of the House of Commons. An amendment is needed to section 292 to reflect the fact that expenses payments are now administered

by IPSA under the PSA and to broadly continue the tax treatment of accommodation expenses paid to MPs.

24. Section 294 of ITEPA exempts from tax expenses paid to MPs to cover the costs of certain visits to EU institutions or to the Parliaments of other EU member states. Like section 292, the exemption is tied to payments that are made in accordance with a resolution of the House of Commons. Again, these payments are now made by IPSA under its scheme and an amendment to section 294 is needed to reflect this. The amendment also extends the exemption to cover travel to the national Parliaments of Council of Europe member states.

25. To recognise the requirement of MPs of having to carry out their duties in both their constituencies and Westminster, the general rules which allow tax relief for expenses incurred on work-related travel have, under a long standing concession, been extended in the case of MPs.

26. This concessionary treatment will be ended from 7 May 2010 and instead these amendments to ITEPA will provide a statutory exemption for certain travel expenses paid or reimbursed to MPs by IPSA as expenses necessarily incurred in the performance of MPs' Parliamentary functions.

27. Prior to 7 May 2010 MPs were reimbursed the cost of certain travel by spouses and, by concession, no liability to income tax arose. The IPSA scheme reimburses some travel by MPs' spouses or partners, but in more restricted circumstances, and these amendments will exempt those payments from tax.

28. The costs of evening meals purchased by MPs and eaten on the Parliamentary estate when the House of Commons is sitting late were in some circumstances previously paid under the allowance for overnight accommodation expenses and so subject to the income tax exemption at section 292 of ITEPA. Under the IPSA scheme, payments in respect of such meals are paid separately from Accommodation Expenses. A new provision is being introduced to exempt from tax the cost of these meals reimbursed under IPSA's scheme.

Section 8Schedule 5: Amounts Not Fully Recognised for Accounting Purposes

Summary

1. Section 8 introduces Schedule 5, which amends the corporation tax rules on loan relationships and derivative contracts that apply to amounts that are not fully recognised for accounting purposes. Where a company 'derecognises' a loan or derivative (and its associated cash flows) in accordance with generally accepted accounting practice (GAAP), in specified circumstances amounts are brought into account for tax purposes as if the accounts had in fact recognised them. The Schedule amends these rules to extend the circumstances in which 'derecognition' is overridden for tax purposes.

Details of the Schedule

2. Paragraph 1 amends section 311 of the Corporation Tax Act 2009 (CTA). Section 311 currently applies in three cases (referred to as Conditions A, B and C) where a company is, or is treated as being, party to a creditor loan relationship in respect of which it does not fully recognise amounts in its accounts. The three cases are, respectively, where the company is also a party to a debtor loan relationship, or has received a capital contribution, or has issued securities. Where one of the conditions applies, the company is required to recognise for tax purposes the full amount of the credits and debits on the creditor loan relationship.

3. Paragraph (1)(2) amends section 311(2) CTA by adding a new condition ("Condition D") to the circumstances in which the rule in section 311 of CTA applies. Paragraph 1(6) inserts the new condition as new section 311(4B), which specifies that it applies

where a company at any time acquires or varies a "relevant interest" in a company, partnership or trust.

4. Paragraph 1(8) inserts new section 311(5A) which defines "relevant interest" as an interest in a company's shares, or a partnership's profits or capital, or a trust's property.

5. Paragraphs 1(3), 1(4) 1(5) and 1(7) amend each of Conditions A, B and C so that they apply whenever the company is party to the debtor loan relationship, or receives the capital contribution, or issues securities. At present, these Conditions only apply where these circumstances occur in the same accounting period as that in which the creditor loan relationship is derecognised.

6. Paragraph 2 makes consequential changes to section 312 of CTA to reflect the fact that as a result of the changes made by paragraph 1, section 311 now applies where the Conditions in that section are met in "any period".

7. Paragraph 3 makes equivalent changes to section 599A of CTA which currently applies in two cases, (referred to as Conditions A and B), where a company is, or is treated as being party to a derivative contract in respect of which it does not fully recognise amounts in its accounts. The two cases are, respectively, where the company has received a capital contribution, or has issued securities. Where one of the conditions applies, the company is required to recognise for tax purposes the full amount of the credits and debits on the derivative contract.

8. Paragraph (3)(2) amends section 599A(2) of CTA by adding a new condition ("Condition C") to the circumstances in which the rule in section 599A CTA applies. Paragraph 3(7) inserts the new condition as new section 599A(5A), which specifies that it applies where a company at any time acquires or varies a "relevant interest" in a company, partnership or trust. New section 599A(5B) defines "relevant interest" as an interest in a company's shares, or a partnership's profits or capital, or a trust's property.

9. Paragraph 3(3), 3(4), 3(5) and 3(6) amend each of Conditions A and B so that they apply whenever the company receives the capital contribution, or issues securities, rather than as now only where these circumstances occur in the same accounting period as that in which the derivative contract is derecognised.

10. Paragraph 4 sets out the commencement provisions for the changes, which have effect for accounting periods beginning on or after 22 June 2010. An accounting period beginning before and ending after this date is treated as two separate periods ending and beginning on this date respectively.

Background Note

11. The corporation tax rules that apply to loan relationships and derivative contracts are based on the principle that amounts brought into account for tax purposes as credits and debits under those rules are those that, in accordance with GAAP, are recognised in determining a company's profit or loss for the period.

12. In certain circumstances, where a company holds a loan or derivative that is matched with another financial instrument issued by it then it may be permissible under GAAP for the loan or derivative or amounts arising in respect of the loan or derivative not to be recognised in determining the company's accounting profits or losses for the period. For example, a company may have made a loan or hold securities from which it receives income in the form of interest, and have issued fixed rate preference shares under which matching amounts are paid as dividends. While the interest income and dividend expense match each other economically, following the accounting treatment in such a case gives rise to a tax advantage, since interest is normally fully taxable and the dividends are not deductible.

13. It is HM Revenue & Customs' (HMRC) view that such non-recognition or de-recognition is not to be observed for tax purposes where the accounting treatment does

not fairly represent the profits. But sections 311 and 312 (for loan relationships) and 599A and 599B of CTA (for derivative contracts) codify the treatment, and prevent companies arguing that where a receipt under a loan relationship (or derivative contract) is matched with a payment (such as a dividend), there is no net liability to tax, even though no deduction is due for the payment under the Corporation Tax Acts.

Section 9: Insurance Companies: Business Transfers Involving Excess Assets

Summary

1. Section 9 introduces a new anti-avoidance rule, which ensures that section 432CA of the Income and Corporation Taxes Act 1988 (ICTA), introduced by Finance Act (FA) 2010, cannot be circumvented by the transfer of long-term insurance business from one company to another.

2. The section applies when:

   - a company which is not a non-profit company transfers business from a non-profit fund to the non-profit fund of another company;
   - the fair value of assets transferred exceeds the amount of liabilities transferred; and
   - either the transferor or the transferee (or both) has a main purpose of securing a reduction of tax payable, by way of amounts falling to be apportioned under section 432C of ICTA by the transferee rather than by the transferor because of the transfer.

3. Where the section applies, the difference between the fair value of assets transferred and the amount of the liabilities transferred (the “chargeable excess”) is deemed to be a taxable receipt of the transferor in the period of account ending immediately before the transfer, or if there is no such period, the period of account during which the transfer occurs.

4. To prevent double taxation a corresponding relief is given in the transferee company as and when the chargeable excess is demonstrably brought into account and would therefore become taxable income of the transferee. In cases where the chargeable excess is not brought into account straightaway, it is necessary to determine how much, if any, of it has been brought into account in a period of account. To do this, there is a comparison between the line 51 amount (broadly the excess of the value of assets over liabilities of the fund) at the end of the period and the chargeable excess. The corresponding relief for that period is the difference between the line 51 amount and the chargeable excess reduced by any corresponding relief given for earlier periods of account.

Details of the Section

5. Subsection (1) inserts new section 432CB into Chapter 1 of Part 12 of ICTA.

6. New sections 432CB(1), (2) and (3) set out the conditions under which the provisions apply. Subsection (2) specifies that there must be an excess of the fair value of the assets transferred over the amount of the relevant liabilities transferred (this being the “chargeable excess”). It specifies the nature of the relevant liabilities by reference to the appropriate lines in Form 14 of a periodical regulatory return. The terms of subsection (1) make clear that these must be liabilities which are transferred out of a non-profit fund of the transferor into a non-profit fund of the transferee.

7. New section 432CB(4) brings the chargeable excess into account as a receipt in the transferring company under section 83(2) of FA 1989 in the form of an increase in the value of non-linked assets in the period of account ending immediately before the transfer, or if there is no such period, the period of account during which the transfer occurs.

8. New section 432CB(5) applies where the transferee company does not show an amount in line 51 of Form 14 of its periodical regulatory return for the first period of account ending on or after the transfer date. It ensures that profits are not taxed in both the transferring and recipient companies by specifying that the chargeable excess is brought into account by the recipient company as a decrease in the value of non-linked assets. The absence of an amount in line 51 of Form 14 means that recognition of the chargeable excess has not been deferred. The deemed decrease therefore has effect in the first period of account ending on or after the transfer date.

9. New section 432CB(6) applies where the transferee company does show an amount in line 51 of Form 14 of its regulatory return for the first period of account ending on or after the transfer date, and the amount shown at line 51 of the Form 14 for the first period of account ending on or after the transfer date, or for any subsequent period (known as an "affected period"), is less than the total chargeable excess amount. The existence of an amount in line 51 of Form 14 means that there has been a deferral of taxable profits. Relief is available in any affected period only to the extent that the chargeable excess has demonstrably not been deferred. So relief is restricted to the "relevant amount".

10. New section 432CB(7) defines the "relevant amount" referred to in subsection (6) as the amount by which the line 51 amount is less than the total chargeable excess amount. The total chargeable excess amount, defined in subsection (8), aggregates all chargeable excesses, where they have arisen from different transfers, so that there is only one relevant amount for any affected period.

11. New sections 432CB(10) and (11) define "the transfer scheme arrangements" referred to in the test of purpose in subsection (3) as the insurance business transfer scheme and "any relevant associated operations", the latter term being further defined.

12. New section 432CB is aimed at companies which are not non-profit companies as defined in section 431 of ICTA. Companies may be able to elect under section 83YA(9) of FA 1989 to be treated as non-profit companies. New section 432CB(13) ensures that companies with such an election in force are regarded as non-profit companies for the purposes of new section 432CB, and therefore excluded from its scope.

13. Subsection (2) of the section sets out that the new rules introduced have effect in relation to transfers of business taking place on or after 24 March 2010.

Background Note

14. Where a life insurance company writes more than one type of insurance business, apportionment rules are used in determining the profits from each type of business. For non-profit funds this apportionment is on the basis of the liabilities to policyholders for each type of business in the fund.

15. The regulatory return, which is used as the starting point for determining life assurance business profits, allows companies to defer recognition of profits in a non-profit fund and this deferral is effective for tax purposes. When income and gains are recognised they are apportioned between categories of business on the basis of the mix of business liabilities at the time when the profits are recognised, not when they accrued. HM Revenue & Customs has seen a case where a company recognised a substantial amount of deferred income and gains, accrued in a period where the business was substantially life insurance business, in a period of account where there were no net life insurance business liabilities. This manipulation could have the effect of eliminating the tax due on these profits, particularly where non-profit funds were concerned.

16. In the light of this case, FA 2010 introduced section 432CA of ICTA. This legislation prevented companies achieving a tax benefit by requiring them, in appropriate cases, to apportion income and gains on the basis of an earlier year or years than that in which they are recognised.

17. It was recognised, however, that section 432CA could be circumvented if profits were effectively transferred to another company, where they would ultimately be recognised.

18. A Technical Note was issued on 24 March 2010 setting out the Government's intention to close this loophole, and to consult on the form of the legislation required. That consultation has now taken place, and is taken into account in new section 432CB of ICTA.

Sections 10 & 11: Final Provisions

Section 10: Interpretation

1. This section provides for the use of abbreviations for a variety of Acts. For example, it provides for the use of "ICTA" as an abbreviation for the Income and Corporation Taxes Act 1988.

Section 11: Short Title

2. This section provides for the Act to be known as the "Finance (No. 2) Act 2010" upon Royal Assent.