These notes refer to the Finance Act 2012 (c.14) which received Royal Assent on 17 July 2012

FINANCE ACT 2012

EXPLANATORY NOTES

INTRODUCTION

Section 11: Gains from Contracts for Life Insurance Etc

Summary

1. This section affects the taxation of certain life insurance policies, life annuity contracts and capital redemption policies under the chargeable event gain regime. It addresses income tax avoidance by putting beyond doubt that gains liable to income tax are not reduced where there are certain untaxed gains earlier in the life of the policy or contract, or by the use of certain cluster policy arrangements. The measure has effect for relevant policies and contracts made on or after 21 March 2012 and for pre-existing policies where certain events arise on or after this date.

Details of the Section

2. Subsection (1) adds new section 473A to the special rules for life insurance policies, life annuity contracts and capital redemption policies, which are contained in Chapter 9 of Part 4 Income Tax (Trading and Other Income) Act 2005.

3. New section 473A treats connected policies and contracts as a single policy for the purposes of the chargeable event gain regime.

4. Subsections 2 and 3 of new section 473A provide that policies are treated as connected where a policy is issued by reference to another policy (a related policy) on terms that would not be expected in isolation. This will apply where the terms of either policy are significantly more or significantly less favourable than would be expected if the other policy were ignored, or if other related policies were ignored.

5. Subsection 4 of new section 473A provides that if an additional policy is connected to at least one but not all of a number of other policies that are themselves connected, all of these policies will be treated as connected.

6. Subsection (2) amends section 491(2) Income Tax (Trading and Other Income) Act 2005 to impose a restriction on the deduction for gains arising from certain earlier chargeable events (such as part withdrawals) in calculating the amount of gains that may subsequently arise when the same policy comes to an end or is assigned in full. The deduction will only apply to the extent that the earlier gains were attributable to one or more of the persons treated as chargeable to tax under the chargeable event gain regime, or were taken into account when calculating the income of a person under rules for the Transfer of Assets Abroad (Part 13, Chapter 2 of the Income Tax Act 2007).

7. Subsection (3) amends section 552 Income and Corporation Taxes Act 1988 so that reporting obligations for insurers will not be affected by the restriction on deductions for earlier gains.

8. Subsection (4) ensures that the new rules will apply to all policies and contracts made on or after 21 March 2012.

9. Subsections (5) and (6) ensure that the new rules will also apply to policies and contracts made before 21 March 2012:

   - which are varied on or after 21 March 2012 so as to increase the benefits secured. For this purpose, the exercise of an option in the policy or contract, on or after 21 March 2012, is treated as a variation;
   - where all of part of the rights are assigned to another person on or after 21 March 2012. This applies whether or not the assignment is for money or money's worth;
   - where all or part of the rights conferred by the policy become held as security for a debt on or after 21 March 2012.

Background Note

10. Gains from life insurance policies, life annuity contracts and capital redemption policies are taxed as income. They can arise on the happening of "chargeable events" such as the maturity of a policy, an assignment for money or money's worth and surrenders of all or part of the rights under a policy.

11. These rules apply to each individual policy. However arrangements have been designed with the aim of deferring income tax that may arise when policies come to an end by 'shifting' into one policy investment profits attributable to premiums paid into a number of different policies. The arrangements ensure that these policies, with no investment gains as a result of the "shift" referred to above, are brought to an end first with no tax liability arising even though economic investment profits may arise from the premiums paid into these policies.

12. This measure removes any scope to defer income tax in this way by recognising the economic position and treating all such interdependent policies as a single policy for the purposes of the chargeable event gain regime. Standard industry arrangements which divide a sum invested across a number of identical but genuinely distinct and economically self-contained policies will not be affected.

13. The amount of gain when a policy comes to an end is calculated by deducting the total amount of premiums paid into the policy plus gains that have previously arisen under the policy (earlier gains); from the total value of any benefits received over the whole life of the policy. Tax may then be due where any gains resulting from the calculation are included in the income of one of the persons chargeable to tax under the special income tax rules for life insurance policies.

14. However, there was no requirement that the earlier gains need to have formed part of the income of one of these persons. A number of income tax avoidance schemes took advantage of the deduction for earlier gains to reduce the amount of gains liable to income tax when a policy comes to an end. These schemes used arrangements under which earlier gains arose when there was no person liable to tax on them (because, for example, the earlier gains were attributable to a person who was not UK resident) in order to reduce income tax otherwise due on investment profits from life insurance policies. This measure removes such opportunities.