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

FINANCE ACT 2012

EXPLANATORY NOTES

INTRODUCTION

Sections 55 to 179Schedules 16 to 19*: *Solvency Ii and the Taxation of Life Insurance Companies

Summary

1. This legislation establishes a new regime for the taxation of life insurance companies. It represents a wide-ranging and fundamental revision of both the basis on which life companies' taxable profits are computed and the detailed rules by which those profits are taxed.

Details of the Sections

Part 2

Chapter 1

2. Chapter 1 contains sections 55 to 65 which explain the structure of this Part of the Act and define terms used in the legislation.

3. Section 56 defines "life assurance business", and section 57 defines "basic life assurance and general annuity business" (BLAGAB), which excludes "protection business", among other items. Sections 58 to 62 define terms used in section 57.

Chapter 2

4. Chapter 2 sets out the charge to tax on BLAGAB business, which is taxed on an I - E basis.

5. Section 66 explains that BLAGAB, non-BLAGAB long-term business and general insurance are to be treated as separate businesses.

6. Section 67 provides an exception to the separate trade treatment for BLAGAB when substantially all of the long-term business is not BLAGAB.

7. Section 68 imposes the charge to corporation tax on the I - E profit for BLAGAB; the "I - E profit" is explained in section 73.

8. Section 69 gives precedence to the I - E charge over the general charge to corporation tax on trade profits under section 35 of the Corporation Tax Act (CTA) 2009.

9. Section 70 explains what is meant by "the I - E rules".

10. Section 71 applies the general corporation tax charge on trade profits to profits of non-BLAGAB long-term business, subject to Chapter 6 of the legislation and specific rules for transfers of non-BLAGAB long-term business.

11. Section 72 excludes companies carrying on only Permanent Health Insurance (PHI) business from Part 2 of the legislation and from provisions elsewhere in the Corporation

Tax Acts which make special provision for long-term business carried on by insurance companies.

Chapter 3

12. Chapter 3 explains the I – E basis.

13. Section 73 sets out the steps used to calculate the I – E profit (where the result is a positive amount) or the excess BLAGAB expenses (where the result is a negative amount). It points to other sections where specific terms are explained.

14. Section 74 lists items that come within the definition of income in step 1 of section 73.

15. Section 75 explains how to calculate the BLAGAB chargeable gains for the purposes of step 2 of section 73.

16. Section 76 explains how to calculate the BLAGAB management expenses for the purposes of step 5 of section 73.

17. Sections 77 and 78 define some of the terms used in the calculation of BLAGAB management expenses in section 76.

18. Section 79 sets out special rules for acquisition expenses (which are defined in section 80). These are expenses that are payable for the purpose of the acquisition of new business. They are spread over 7 years rather than deducted in full when incurred.

19. Section 81 details some specific amounts that are allowable as BLAGAB management expenses.

20. Section 82 applies certain restrictions, which apply to the management expenses of a company with investment business, to the calculation of BLAGAB management expenses.

21. Sections 83 and 85 bring into the new regime the existing provisions allowing relief, in computing I - E profits, for certain annuity payments.

22. Section 86 modifies, for I – E purposes, the rules in CTA 2009 regarding the taxation of profits from property businesses. It provides that a life insurance company may have more than one property business. There is a separate property business in respect of property held other than for the purposes of the long-term business. Separate businesses are established for property matched to BLAGAB liabilities; for property matched to other long-term liabilities; and for unmatched property held for the purposes of the long term business.

23. Section 87 sets out the treatment, for I – E purposes, of losses from property businesses. To the extent that they are referable to BLAGAB, such losses are to be treated as BLAGAB management expenses.

24. Section 88 ensures that for the purposes of the I – E profit calculation the rules on loan relationships, derivative contracts and intangible fixed assets apply as though the BLAGAB business were not a trade. The relevant rules in CTA 2009 apply accordingly.

25. Section 89 provides for certain BLAGAB miscellaneous income to be treated as I – E receipts in so far as it exceeds miscellaneous losses.

26. Sections 90 and 91 replicate existing provisions which impute investment return for I – E purposes when certain risks under BLAGAB contracts of insurance are reinsured.

27. Section 92 deems certain BLAGAB trading receipts, which would not otherwise fall within the charge to corporation tax, to be I – E receipts.

28. Section 93 requires a comparison between the BLAGAB trade profit and the I - E result and imputes an additional I - E receipt if the former is greater than the latter.

29. Section 94 requires that, in making the comparison in section 93, any exempt dividends referable to BLAGAB are to be included as I - E receipts. This is because all dividends are taken into account when computing the BLAGAB trade profit.

30. Section 95 allows non-BLAGAB allowable losses to be deducted from the shareholders' share of BLAGAB chargeable gains, but not to the extent that they would create an I - E loss.

31. Section 96 restricts management expenses of an overseas life insurance company carrying on BLAGAB business in the UK where the income of the company allocated to BLAGAB includes FOTRA (free of tax to residents abroad) profits.

Chapter 4

32. Section 97 introduces Chapter 4, which contains rules for the allocation to BLAGAB of investment income and losses, expenses, and chargeable gains and allowable losses for the purposes of I – E.

33. Section 98 requires that investment income or losses, and expenses referable to BLAGAB are to be determined by an acceptable commercial method. It explains what is an acceptable commercial method. HM Treasury is given a power to make regulations prescribing what is, or is not, an acceptable commercial method.

34. Sections 99 to 101 explain how chargeable gains and allowable losses referable to BLAGAB are determined.

35. Section 100 provides that gains or losses on assets are attributable to BLAGAB to the extent that the assets are wholly or partly matched to BLAGAB liabilities. The concept of matching is explained in section 138.

36. Section 101 explains that the extent to which gains or losses on assets, which are not matched to BLAGAB liabilities, are referable to BLAGAB is determined using an acceptable commercial method. The section applies to the unmatched proportion of a gain or loss where the asset is partly matched. It explains what is an acceptable commercial method, and gives HM Treasury a power to make regulations prescribing what is, or is not, an acceptable commercial method.

Chapter 5

37. Chapter 5 sets out the rate of tax to be applied to the policyholders' share of the I–E profit and sets out how that share is to be determined.

38. Section 102 defines the rate of tax applicable to the policyholders' share of the I – E profit as the basic rate for income tax.

39. Section 103 sets out how the policyholders' share of the I – E profit is to be determined. For mutual insurance companies, the whole of the profit is attributable to policyholders.

40. Sections 104 and 105 explain terms used in sections 103 and 104.

41. Section 106 provides for a deduction in the calculation of the BLAGAB trade profits for tax of the accounting period charged at the policyholder rate.

42. Section 107 provides for an adjustment to BLAGAB trade profits in respect of deferred policyholder tax, and explains how it is to be calculated.

43. Section 108 defines terms used in section 107 and specifies the BLAGAB assets and liabilities in respect of which an adjustment may arise under that section. HM Treasury is given a power to amend by regulation the list of BLAGAB assets and liabilities.

Chapter 6

44. Section 109 applies the rules in Chapter 6 to the calculation of BLAGAB trade profit or loss and the non-BLAGAB long-term business profit.

45. Section 110 allows a deduction in calculating profits for sums allocated to policyholders except where certain sums of a capital nature are allocated to with-profits policyholders.

46. Section 111 brings dividends and other company distributions into account as receipts in calculating the profits unless they are capital distributions. This section overrides the general rule that such dividends and distributions are not taxable.

47. Section 112 disapplies the provisions in CTA 2009 which exempt the indexation return on index-linked gilt-edged securities (gilts) from tax under the loan relationship rules in computing trade profits. But the section does not apply where the gilts are held to back index-linked PHI liabilities to policyholders.

48. Section 113 excludes profits, receipts and expenses arising from long-term business fixed capital assets from the computation of profits.

Chapter 7

49. Section 114 explains that Chapter 7 details how to allocate accounting profits, losses and various adjustments between BLAGAB and non-BLAGAB long-term business.

50. Section 115 requires that the allocation is to be in accordance with an acceptable commercial method. The method must be consistent with the method used for the purposes of section 41(allocation of BLAGAB income, etc). The section also gives HM Treasury the power to prescribe cases in which a method is to be, or is not to be, regarded as an acceptable commercial method.

Chapter 8

51. Chapter 8 deals with changes in the allocation of assets and share pooling rules for life insurance business.

52. Section 116 deems a disposal and reacquisition at fair value when an asset moves between the categories set out in the section. This rule does not apply where none of the profits of a company are taxed on an I - E basis.

53. Section 117 modifies the rules in section 116 for overseas life insurance companies.

54. Section 118 sets out the rules where there is a transfer of business and as a consequence assets transferred move from one category to another.

55. Sections 119 and 120 adapt the capital gains share pooling rules for life insurance companies, including overseas life insurance companies.

Chapter 9

56. Chapter 9 explains how relief is provided for BLAGAB trade losses.

57. Section 123 applies the general trade loss rules in CTA 2009 to BLAGAB trade losses.

58. Section 124 describes how a BLAGAB trade loss may be carried forward to later accounting periods.

59. Section 125 explains the application of group relief rules to BLAGAB trade losses.

60. Section 126 says that losses relieved by way of section 123 or section 125 are to be reduced by the amount of any non-trading loan relationship deficit for the accounting period.

61. Section 127 prevents various reliefs (as identified in section 127(3)) from being set against the policyholders' share of the I – E profit.

Chapter 10

62. Chapter 10 contains the rules on transfers of long-term business.

63. Where there is a transfer of BLAGAB business, Section 128 permits the transferee to receive relief for spread acquisition expenses (see section 79) which would have become available to the transferor in a period after the transfer if the transfer had not taken place.

64. Section 129 sets out the rules for the calculation of BLAGAB trade profits of the transferor and the transferee where there is a transfer of BLAGAB business within a group or from a mutual company to a non-mutual company.

65. Section 130 provides that, when there has been a transfer of business between unconnected parties on or after 1 January 2013, the transferee will get relief for the amortisation of an asset recognising the value of future profits arising from the business acquired when that amortisation is charged to the accounts .

66. Section 131 applies sections 129 and 130 where there is a transfer of non-BLAGAB long-term business.

67. Section 132 is an anti-avoidance provision, which applies where, on or after 1 January 2013, there is a transfer of long-term business (or part of a business) and the main purpose of a company entering into one or more of the arrangements is an unallowable purpose. Where it applies, the section requires necessary steps to be taken to negate the tax advantage arising.

68. Sections 133 and 134 set out the clearance procedure by which a company can seek confirmation from HMRC that section 132 does not apply.

69. Section 135 states that whether companies are members of the same group for the purposes of Chapter 10 is to be determined in accordance with section 170(2) to (11) of the Taxation of Chargeable Gains Act 1992.

Chapter 11

70. Chapter 11 contains definitions of terms and abbreviations used in this Part.

71. Section 138 explains the concept of matching of assets (or part assets) to liabilities, which is used in Chapter 4 and Chapter 8 of this Part.

Chapter 12

72. Section 142 gives HM Treasury powers to amend the legislation relating to life assurance business by way of secondary legislation in consequence of powers being exercised under the Financial Services and Markets Act 2000 (FSMA 2000).

73. Section 143 allows the meaning of the term "insurance business transfer scheme" to be amended by order following any change to section 105 FSMA 2000.

74. Section 144 provides a power to modify by regulations the legislation relating to overseas life insurance companies.

75. Sections 146 and 147 introduce Schedules 16 and 17, which contain minor and consequential amendments and transitional provisions respectively.

76. Section 148 states that the provisions of this Part are to have effect for accounting periods beginning on or after 1 January 2013.

77. Section 149 ensures that all life insurance companies will have an accounting period ending on 31 December 2012.

Part 3

78. Part 3 provides specific rules for the taxation of life assurance business and other long-term business carried on by friendly societies. Section 150 gives an overview of the contents of Part 3.

79. Section 151 applies the Corporation Tax Acts to long-term business carried on by friendly societies in the same way that they apply to mutual business carried on by insurance companies.

80. Section 152 states that the transfer of business rules in Chapter 11 of Part 1 or elsewhere apply to friendly societies and gives HM Treasury the power to modify those provisions by way of regulations.

81. Section 153 states that certain exempt BLAGAB or eligible PHI business will not be liable to corporation tax, and section 154 defines the term "BLAGAB or eligible PHI business". Section 155 defines "exempt" BLAGAB or eligible PHI business.

82. Section 156 sets out specific provisions relating to exempt BLAGAB or PHI business (see section 155) for friendly societies whose rules prevent them from writing business above specified values.

83. Section 157 applies on a transfer of business to prevent any long-term business transferred to a friendly society from being exempt unless section 158 applied to the contracts before the transfer.

84. Section 158 allows previously exempt business to remain exempt if it is transferred to an insurance company, or the friendly society converts to a company. Such business comprises a separate business in the insurance company. Section 158 also provides for regulations to be made to modify the rules in the section.

85. Section 159 prevents profits on certain policies from coming within the exemptions from corporation tax provided by the legislation where the limits of the maximum benefits payable to members are breached.

86. Section 160 sets out limits on the value of exempt contracts which a policyholder may hold with one or more friendly societies at any time. Section 161 makes additional provisions for the purposes of section 160.

87. Section 162 provides for a friendly society or insurance company to require a policyholder to make a statutory declaration that the limits in section 105 have not been exceeded.

88. Section 163 allows the HMRC Commissioners to give a direction where it is considered necessary for the protection of revenue that an "old" society is to lose its status as an "old" society in respect of business carried on after the date of the direction.

89. Section 164 exempts a registered qualifying society (as defined) from a liability to tax on profits other than from life assurance business or PHI within "BLAGAB or eligible PHI business", providing the society makes a claim.

90. Section 165 exempts an incorporated qualifying society (as defined) from a liability to tax on profits other than from life assurance business or from PHI within "BLAGAB or eligible PHI business", providing the society makes a claim.

91. Section 166 explains that an insurance company acquiring business other than life insurance business or PHI within "BLAGAB or eligible PHI business" from a friendly society exempted under section 164 or 165 is exempt from corporation tax on the profits from that business. A friendly society converting to an insurance company is likewise

exempt. Such business comprises a separate business in the insurance company. Section 166 also provides for regulations to be made to modify the rules in the section.

92. Section 167 explains what happens when business is transferred between friendly societies and sections 164 or 165 previously applied to the transferor. Business other than life insurance business or PHI within "BLAGAB or eligible PHI business" which was exempt in the transferor remains exempt in the transferee.

93. Section 168 allows the HMRC Commissioners to make a direction withdrawing a registered or incorporated society's qualifying status in certain circumstances.

94. Section 169 sets out the circumstances in which a payment by a non-qualifying society to a member is treated as a qualifying distribution.

95. Where a registered friendly society becomes incorporated, Section 170 provides that assets of a branch of the society which are identified under section 6(5) of the Friendly Societies Act 1992 as not transferred to the new company are nonetheless to be treated as assets of the company for tax purposes.

96. Section 171 provides, where a claim is made, for an exemption from corporation tax for unregistered and unincorporated friendly societies whose income does not exceed £160 a year.

97. Section 176 introduces Schedule 18, which contains consequential amendments arising from Part 3.

98. Section 177 introduces Schedule 19, which contains transitional provisions arising from Part 3.

99. Section 178 states that the provisions of this Part are to have effect for accounting periods beginning on or after 1 January 2013.

100. Section 179 ensures that all friendly societies will have an accounting period beginning on 1 January 2013 (even if that would not otherwise be the case).

Schedule 16

101. Schedule 16 contains minor and consequential amendments to other Acts that flow from this new legislation.

102. Paragraph 87 inserts a new section 213A into the Taxation of Capital Gains Act (TCGA) 1992. This provides a power for HM Treasury to make regulations to ensure that the new Controlled Foreign Companies rules in Schedule 20 of FB2012 interact appropriately with section 212 TCGA.

Schedule 17

103. Schedule 17 contains transitional provisions.

Schedule 17Part 1

104. Paragraph 1 explains that Part 1 of Schedule 17 provides for deemed receipts or deemed expenses to arise on transition for the purposes of computing BLAGAB trade profits and non-BLAGAB long-term business profits. The general rule is that receipts and expenses are treated as arising over a 10-year period.

105. Paragraph 2 explains what is meant by "the 2012 balance sheet" and "the 2012 periodical return".

106. Paragraphs 3 and 4 deem a balance sheet and/or periodical return to have been drawn up at 31 December 2012 if the company does not have an actual balance sheet and/or periodical return at that date.

107. Paragraph 5 requires the insurance company to calculate the total transitional difference by way of a comparison of the amount attributed to shareholders (that is, amounts which would have been recognised in profits if an accounts basis had always applied) as at 31 December 2012 with the cumulative taxed surplus at the same date (that is, surplus recognised in the regulatory return and taken into account when computing profits). The paragraph permits HM Treasury to prescribe by regulations adjustments to the method by which the amount attributed to shareholders is calculated.

108. Paragraph 6 requires the insurance company to identify the items which together make up the total transitional difference, and to allocate a positive or negative amount to each item. The paragraph permits HM Treasury to prescribe by regulations how the items are to be determined.

109. Paragraph 7 provides that the items making up the total transitional difference are "relevant computational items" unless they are "excluded items". It specifies certain excluded items and gives HM Treasury power to specify others by regulations.

110. Paragraph 8 apportions the relevant computational items between the pre-transition categories of business, that is, BLAGAB, gross roll-up business (GRB) and PHI. Amounts apportioned to PHI are ignored in applying the rest of the transitional rules.

111. Paragraphs 9 and 10 explain that relevant computational items (or parts of them) allocated to BLAGAB or non-BLAGAB long-term business are treated as receipts or expenses in computing BLAGAB trade profits or profits of non-BLAGAB long term business for accounting periods commencing on or after 1 January 2013.

112. Paragraph 11 describes the 10-year period over which receipts and expenses are treated as arising. The 10-year period begins on 1 January 2013. It excludes receipts which are "relevant court-protected items" (see paragraph 12).

113. Paragraph 12 defines a relevant court-protected item, and provides that receipts arising from such items are treated as arising over a 10-year period beginning on the date the court order ceases to be in force or 1 January 2015, whichever is the earlier.

114. Paragraphs 13 and 14 explain how transitional receipts or expenses are to be treated where there is a subsequent transfer of insurance business.

115. Paragraph 15 deals with the treatment of transitional amounts where an insurance company ceases to carry on long-term business other than as a result of a transfer.

116. Paragraph 16 provides that where there is an unrelieved charge under the financing arrangement-funded transfer legislation in section 83YC of Finance Act 1989 that charge is to be treated as a negative 'relevant computational amount'.

117. Paragraph 17 is an anti-avoidance provision. Where, on or after 21 March 2012, an insurance company enters into arrangements or does something in connection with the transitional rules, and its purpose is unallowable, an officer of Revenue and Customs may take steps to nullify any tax advantage. An unallowable purpose includes securing a tax advantage in connection with the transitional rules.

118. Paragraphs 18 and 19 set out the clearance procedure by which a company can seek confirmation from HMRC that paragraph 17 does not apply.

119. Paragraph 20 makes special provision for overseas life insurance companies in certain circumstances.

Schedule 17Part 2

120. Paragraph 21 provides for a company to make an irrevocable election to treat certain contracts of insurance effected prior to 1 January 2013 as having been made on or after that date for the purposes of section 62

121. Paragraph 22 prevents an amount being taken into account in computing BLAGAB trade profits or non-BLAGAB long-term business profits where it was already taken into account in computing trade profits in a period before the transition.

122. Paragraph 23 prevents double relief where an expense appeared in the regulatory return of a pre-transition period and was spread forward into a post-transition period under current tax rules. If that same expense were charged to the profit loss account in a post-transition period, double relief would, but for this paragraph, arise.

123. Paragraph 24 applies to intangible fixed assets which were excluded from Part 8 of CTA 2009 under the old law, but which are brought within Part 8 by this legislation. Expenditure incurred before 1 January 2013 is to be ignored in determining amounts to be brought into account under Part 8.

124. Paragraph 25 makes clear that the transition of assets from the existing categories in section 440 ICTA to the new categories in sections 116 to 118 does not trigger a deemed disposal and reacquisition.

125. Paragraph 26 makes clear that the transition of assets from the existing holdings of securities in section 440A ICTA to the new holdings in sections 119 to 121 does not trigger a deemed disposal and reacquisition.

126. Paragraph 27 provides rules for the carry forward of the base cost of existing holdings of securities under section 440A ICTA into the new holdings under sections 119 to 121.

127. Paragraph 28 applies in situations where existing rules at section 210B Taxation of Capital Gains Act 1992 would have operated. It gives identification rules where there is a disposal and acquisition of securities around the transition date.

128. Paragraphs 29 to 32 describe the treatment of various losses and excess management expenses carried forward from an accounting period ending before 1 January 2013 into the new regime.

129. Paragraph 33 permits acquisition costs spread forward under section 86 FA1989 from a pre-transition period to be relieved in a post-transition period.

130. Paragraph 34 permits BLAGAB trade losses to be carried back to pre-transition accounting periods under section 37 CTA 2010.

131. Paragraph 35 states that assets previously treated as assets of the shareholder fund for the last period of account ending before 1 January 2013 are to be treated as fixed capital assets from 1 January 2013. The paragraph defines when an asset is to be regarded as having been an asset of the shareholder fund.

Schedule 17Part 3

132. Paragraph 36 applies where Part 1 of this Act re-enacts an enactment that has been repealed by the legislation. It provides that any statutory instrument which was made under a provision repealed by this legislation and which has effect for accounting periods ending on 31 December 2012 has effect in relation to subsequent accounting periods as if it had been made under the corresponding provision in this legislation.

133. Paragraphs 37 and 38 give HM Treasury a power to make further transitional provisions by way of regulations.

Background Note

134. The EU Solvency II Directive, which is expected to have effect from 2014, will fundamentally change the regulatory reporting framework on which life insurance company taxation is currently based. As a result of the changes which will be introduced by the Directive, regulatory returns made by insurance companies to the Financial

Services Authority will no longer provide the information on which the current basis of taxation relies.

135. A new regime for the taxation of life insurance companies is therefore being introduced, which will apply from 1 January 2013. It aims to simplify the unique and complex rules currently governing life company taxation by bringing them more in line with those which apply to companies generally, and aligning them more closely with the commercial realities of life insurance business. The changes being introduced are extensive; the main points are summarised below.

- Trading profits will be calculated on the basis of life companies' financial statements, in line with general corporation tax rules, rather than being derived from regulatory returns made to the Financial Services Authority, as now.
- Life companies are subject to the "Income minus Expenses" (I minus E) tax basis, which aims to tax (at different rates) profits made by shareholders and the investment return arising for the benefit of certain policyholders. I minus E will continue to apply but, unlike now, only to the type of business where it is appropriate to tax both shareholder profit and policyholder investment return. Life protection business, which does not attract significant investment return, will be excluded from I minus E.
- Three categories of insurance business are currently recognised for tax purposes, all subject to different tax rules. Two of the three existing categories will be amalgamated, reducing their total number to two.
- At present life insurance companies’ investment income, gains and losses are apportioned between categories of business by way of a series of formulae set out in legislation. Under the new regime, the allocation will instead be determined by reference to the actual commercial activities of individual companies.
- Life companies will be brought within the rules on loan relationships and intangible fixed assets which apply to the computation of taxable trading profits for companies generally.