These notes refer to the Income Tax (Trading and Other Income) Act 2005 (c.5) which received Royal Assent on 24 March 2005

INCOME TAX (TRADING AND OTHER INCOME) ACT 2005

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 4: Savings and investment income

Chapter 9: Gains from contracts for life insurance etc.

Calculating gains: general

Overview

1939. Section 491 to 497 set out how to calculate a gain on a chargeable event *other than* one arising on any part surrender or part assignment, or an event in respect of the special charge for personal portfolio bonds.

1940. Section 491 introduces a number of terms which are used throughout the Chapter for the computation of gains (and defines them in subsection (4)). These are:

- "calculation event" (an umbrella term for events, the occurrence of which is dependent on the outcome of one of several prescribed calculations); and
- "excess event", "part surrender or assignment event" and "personal portfolio bond event" (the types of event which may flow from such a calculation).

Section 491: Calculating gains: general rules

1941. This section deals with the calculation rules for all chargeable events other than those triggered by a part surrender or part assignment of rights under the policy or contract, or by the special charge on personal portfolio bonds. It is based on sections 541, 543 and 545 of ICTA and section 79 of FA 1997. (For the relevance of section 79 of FA 1997, see section 490.)

1942. *Subsection (2)* introduces the concepts of the "total benefit value" and the "total allowable deductions". These terms are used in other sections in this Chapter (for example, section 541 (calculation of deficiencies)).

1943. *Subsection (5)* indicates that gains on a previous calculation event include gains on a "related policy" (defined in *subsection (6)*). See *Change 90* in Annex 1.

Section 492: The total benefit value of a policy or contract

1944. This section is based on sections 541, 543, 545 and 548 of ICTA, and section 79(3) of FA 1997.

1945. The "total benefit value" of a policy or contract consists of the value of the policy or contract in relation to the event (paragraph (a)) added to capital sums (or benefits or amounts treated as such) derived from the policy or contract prior to the chargeable event itself (paragraph (b)).

1946. *Subsection (2)* makes clear that capital amounts derived from a related policy are brought in for this purpose.

Section 493: The value of a policy or contract

1947. The value of a policy or contract is determined by reference to the particular kind of event. This section is based on sections 541, 542, 543, and 545 of ICTA, and section 79 of FA 1997.

1948. *Subsections (1)* and *(2)* provide for the value in the majority of events.

1949. In relation to the reference in *subsection (6)* to connected persons, see section 878 of this Act (which applies section 839 of ICTA).

Section 494: The total allowable deductions for a policy or contract

1950. This section is based on sections 541, 543, 545 and 548 of ICTA.

1951. Step 1 in *subsection (1)* lists amounts to be taken into account as deductions. Paragraph (a) deals with the vast majority of cases, where the only item to be taken into account is the total of premiums paid before the chargeable event. See also section 546 (table of provisions subject to special rules for older policies and contracts).

1952. Step 2 in subsection (1) reduces the total allowable deductions for a purchased life annuity by the exempt amount (or capital element) in payments to date. The exempt amount is determined under Chapter 7 of Part 6 of this Act and (as regards the capital element) under ICTA as appropriate (see the commentary on section 473).

1953. Paragraph (b) in Step 1 deals with the repayment of loans which were treated as a part surrender of the rights under the policy or contract.

1954. *Subsection (2)* caters for assignments for money or money's worth of capital redemption policies. In the case of such assignments paragraph (a) in Step 1 in subsection (1) applies to the price paid in respect of the most recent such assignment instead of the premiums paid before that assignment.

1955. *Subsection (3)* makes clear that premiums etc. paid in respect of a related policy (as defined in section 491) are included in the calculation of total allowable deductions.

Section 495: Disregard of certain amounts in calculating gains under section 491

1956. This section contains rules which exclude various amounts from the calculation of the total benefit value under section 492 and the total allowable deductions under section 494 in arriving at the amount of a gain under section 491. It is based on sections 541, 543 and 545 of ICTA.

1957. *Subsections (1)* and *(2)* deal with a retained replacement policy premium. This disregard is based on paragraph 20 of Schedule 15 to ICTA, which deals with the replacement of one qualifying policy by another, where the value of the old policy is used as a premium for the new policy. The old and new policies are treated as a single policy (see section 542). The value of the old policy is disregarded both in working out the total benefit value of that single policy and, as regards use of the value of the old policy as a premium for the new policy, in working out the total allowable deductions for the single policy.

1958. *Subsection (4)* reflects an amendment in FA 2002 of a rule introduced by FA 2001, under which an assignment which is not for money or money's worth (such as a gift) is not treated as giving rise to a chargeable event. But assignments which were not for money or money's worth still have to be taken into account in calculating gains if they occurred in an "insurance year" (see section 499) ending before 6 April 2001.

Section 496: Modification of section 494: qualifying endowment policies held as security for company debts

1959. Although this section refers to a policy held as security for a company's debt (a circumstance in which liability to corporation tax on a gain arises under section 547(1)(b) of ICTA), this modification is part of the income tax rules because liability on that gain can also be attributable to a person to whom sections 464 to 468 apply or are relevant. It is based on section 541 of ICTA. Where this section applies, the eligible amount of the debt is substituted for premiums paid under the policy in calculating any gain. A claim by the debtor company is required.

Section 497: Disregard of trivial inducement benefits

1960. This section is based on ESC B42. It excludes non-monetary benefits costing no more than £30, which are offered as inducements to attract life insurance business, from the computation of any gain under this Chapter. See *Change 91* in Annex 1.

1961. ESC B42 refers to "gifts" but the section refers to "benefits" as a more accurate description of what is provided. It also matches more closely the drafting of the various sections for calculating gains.

1962. *Subsection (3)* provides for a future increase (or increases), but not for any decrease, in the monetary limit set on this disregard. See section 873 of this Act for the procedural rules which apply to secondary legislation made under powers in this Act.

1963. The monetary limit is applied by reference to the "policy or contract and any linked policy or contract" taken as one. This caters for an insurance industry practice of issuing "clusters" of policies to give the policy holder any required flexibility in managing the total investment.