

# **CORPORATION TAX ACT 2009**

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## **EXPLANATORY NOTES**

### **COMMENTARY ON SECTIONS**

#### **Part 7: Derivative contracts**

##### **Overview**

#### **Chapter 6: Special kinds of company**

##### **Overview**

1735. This Chapter contains rules that modify the application of this Part to mutual trading companies or insurance companies. The Chapter does not rewrite paragraph 41 of Schedule 26 to FA 2002 as it is merely introductory.

#### **Section 633: Mutual trading companies**

1736. This section treats the activities of a mutual trading company as not being those of a trade. It is based on paragraph 43 of Schedule 26 to FA 2002.

1737. Because of this section, any credits and debits arising to a mutual trading company do not fall within section 573 (trading credits and debits to be brought into account under Part 3). And any provision that operates in part by reference to whether the company is a party to a contract for the purposes of a trade (or a type of business which constitutes a trade) does not apply to a mutual trading company in that respect.

#### **Section 634: Insurance companies**

1738. This section treats certain activities of an insurance company as not being those of a trade. It is based on paragraphs 41A and 43 of Schedule 26 to FA 2002.

1739. This section has the same effect, in relation to the activities specified in paragraphs (a) and (b), as the preceding section has for mutual trading companies.

1740. For the meaning of “life assurance business” and “basic life assurance and general annuity business”, see section 431(2) of ICTA.

#### **Section 635: Creditor relationships: embedded derivatives which are options**

1741. This section requires a life assurance company to treat a creditor relationship as mentioned in section 585(1) despite the fact that it accounts for that relationship at fair value through profit and loss. It is based on paragraph 45D(3A) of Schedule 26 to FA 2002.

1742. Under generally accepted accounting practice, a company that accounts for a creditor relationship at fair value through profit and loss would not divide the relationship between embedded derivatives and the remaining rights that are a loan relationship. This section overrules that accounting rule for the purposes of both this Part and Part 5 (loan relationships).

**Section 636: Modifications of Chapter 5**

1743. This section makes modifications of Chapter 5 (continuity of treatment on transfers within groups) in respect of insurance companies. It is based on paragraphs 28(1) and (2) and 29 of Schedule 26 to FA 2002.
1744. [Section 625](#) deals with the case where one member of a group of companies replaces another as a party to a derivative contract as the result of a related transaction or similar transactions. It determines the credits and debits to be brought into account by the transferor company and the transferee company by treating both as using the same consideration in relation to that transaction or transactions.
1745. This section first adds two further cases to the list in section 626 of transactions that trigger the operation of section 625. They are cases involving the transfer of classes of insurance business between two companies where the transfer does not already fall within section 625.
1746. *Subsection (4)* then disapplies section 625, in respect of a triggering transaction falling within the original categories listed in section 626, in relation to the transfer of derivative contracts moving into or out of a company's long-term insurance fund.
1747. *Subsection (5)* disapplies section 625 in respect of a triggering transaction falling within the categories treated as added to section 626 by subsection (3), if derivative contracts are in one of the categories set out in section 440(4) of ICTA before the transfer and in a different category after the transfer.
1748. For the meaning of "contract of long-term insurance", "insurance business transfer scheme", "qualifying overseas transfer" and "overseas life insurance company", see section 431(2) of ICTA (as modified, in relation to the meaning of "qualifying overseas transfer", by regulation 6(5) of the [Overseas Life Insurance Companies Regulations 2006 \(SI 2006/3271\)](#)). Because the meaning of "overseas life insurance company" is provided by that section "for the interpretation of the life assurance provisions of the Corporation Tax Acts" (and this section is such a provision), it is unnecessary to rewrite paragraph 29(4) of Schedule 26 to FA 2002.

**Section 637: Investment trusts: profits or losses of a capital nature**

1749. This section and the next except certain capital profits and losses of an investment trust or venture capital trust from the scope of this Part so that credits and debits in respect of such profits or losses do not fall within section 595. This section deals with investment trusts. It is based on paragraph 38 of Schedule 26 to FA 2002 and articles 2 and 3 of [The Investment Trusts and Venture Capital Trusts \(Definition of Capital Profits, Gains or Losses\) Order 2006 \(SI 2006/1182\)](#).
1750. *Subsection (1)* refers to "profits or losses" rather than "profits, gains and losses" as in the source legislation. But there is no difference in the meaning of the two phrases in the context of an investment trust's transactions of a capital nature.
1751. *Subsection (2)* uses the meaning of profits or losses of a capital nature given by [SI 2006/1182](#) for both trusts using UK generally accepted accounting practice and those using international accounting standards. It does not rewrite the meaning given in paragraph 38(3) of Schedule 26 to FA 2002 as the relevant Statement of Recommended Practice uses terms from international accounting standards (and accordingly does not rewrite the part of paragraph 38(2)(a) of that Schedule which refers to that meaning).
1752. *Subsection (4)* contains powers for the amendment by Treasury order of the meaning of "profits or losses of a capital nature" in this section. This rewrites the powers in paragraph 38(2) of Schedule 26 to FA 2002 used to make the order in [SI 2006/1182](#) applying to investment trusts and venture capital trusts that use international accounting standards.

*These notes refer to the Corporation Tax Act 2009  
(c.4) which received Royal Assent on 26 March 2009*

1753. There were similar rules in relation to “capital profits, gains and losses” of authorised unit trusts and open-ended investment companies in paragraphs 32 and 33 of Schedule 26 to FA 2002 with regulatory powers in paragraph 34 of that Schedule. The first two of those paragraphs were omitted by F(No 2)A 2005. Paragraph 34 of that Schedule is now omitted and not rewritten as it is redundant.
1754. [Schedule 1](#) to this Act inserts section 842(2D) and (2E) of ICTA (investment trusts: net excess of relevant credits over relevant credits under this Part treated as income derived from shares or securities for the purposes of approval of a company under that section, so far as the credits and debits are brought into account under section 574). This insertion is based on paragraph 39 of Schedule 26 to FA 2002.

***Section 638: Venture capital trusts: profits or losses of a capital nature***

1755. This section excepts certain capital profits and losses of a venture capital trust from the scope of this Part. It is based on paragraph 38A of Schedule 26 to FA 2002 and articles 2 and 3 of the [Investment Trusts and Venture Capital Trusts \(Definition of Capital Profits, Gains or Losses\) Order 2006 \(SI 2006/1182\)](#).
1756. This section has the same effect for venture capital trusts as section 637 has for investment trusts. See the commentary on that section.
1757. This section does not rewrite paragraph 38A(2)(a)(part) and (3) of Schedule 26 to FA 2002 for the same reasons as those mentioned in the commentary on section 637 in relation to not rewriting paragraph 38(3) of Schedule 26 to FA 2002.