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 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.