These notes refer to the Finance Act 2009 (c.10) which received Royal Assent on 21 July 2009

FINANCE ACT 2009

EXPLANATORY NOTES

INTRODUCTION

Section 46Schedule 23: Insurance Companies

Background Note

15. Currently the tax treatment of additions made by a company to its long term insurance fund (LTIF) is governed by a combination of case law and an unpublished concession in guidance. A company may add capital to its LTIF for regulatory or commercial reasons but in certain circumstances amounts are added with the intention of obtaining a tax advantage.

16. The impact of the existing case law and concession is uncertain for both HMRC and the industry. The legislation attempts to remove that uncertainty by providing that the default position for such capital additions is that they are not taxable. It then identifies a number of sets of circumstances where such an addition has been made where reliefs shall be restricted. At the same time the opportunity has been taken to apply consistent treatment to the allowance of "capital" bonuses paid to policyholders – whether those bonuses are funded from a non-taxable capital addition or some other untaxed source.

17. The income and gains of a company's life insurance business are taxed as they are brought into account in the company's regulatory return to the Financial Services Authority (FSA). In general terms the measure seeks to restrict relief when tax-deductible expenditure is incurred but this is not matched by the bringing into account of a corresponding amount of taxable income. Circumstances in which this may occur, are set out in the following three examples, which correspond to the restrictions to relief found in new section 434AZA and the new subsection (2A) of section 82 of FA 1989.

Example 1: Book value election

18. FSA rules permit an insurance company to recognise the total value of its LTIF assets at an amount less than their admissible value. The use of a value less than admissible value is known as 'making a book value election'. Recognising assets at less than admissible value defers the bringing of income and gains into account for both tax and regulatory purposes. When a non-taxable addition to the fund is available to frank tax-deductible expenditure and the company chooses to defer the recognition of taxable income and gains by way of a book value election there will be a tax loss which does not reflect a commercial loss of the life insurance business.

Example 2: Manipulation of admissible value

19. FSA rules prescribe that, in certain circumstances, generally to reflect concentration and counterparty risk, the admissible value of a company's assets must be less than market value. The admissible value of the fund's assets can be manipulated by acquiring or creating assets which have little or no admissible value. The fair value of the assets of the fund is unchanged. A non taxable addition to the fund may allow a company to create a tax effective reduction in admissible value whilst maintaining the value of the fund for regulatory purposes. Effectively this creates a tax loss where there is no commercial loss.

Example 3: Capital allocations to with-profits policy holders

20. The ability of a company to defer recognition of income and gains allows it to smooth the profits allocated by way of bonuses to with-profits policy holders. Currently all amounts allocated to with-profits policy holders are allowable deductions in computing the profits of a company's life assurance business whether or not that allocation is made out of recognised income and gains.

21. In certain circumstances payments may be made which do not represent an allocation of profits to policyholders but are instead of a capital nature, e.g. a payment for giving up rights under the policy. Such capital payments will represent an acceleration of the allocation of the profits of the fund to policyholders and providing this is matched by an acceleration in the recognition of profits this is unobjectionable. In some circumstances allocations of a capital nature will not be funded from recognised income and gains but will instead be funded by an addition to the fund.

Financing-Arrangement-Funded Transfers to Shareholders ("FAFTS") and Contingent Loans

22. Paragraph 4 provides clarification of the rules governing FAFTS. FA 2008 introduced new rules to deal with FAFTS relating to non-profit funds. FAFTs are a type of financing arrangement whereby a loan made to, or financial reinsurance arrangement made by, an insurance company can have the effect of accelerating taxable surplus. For contingent loans these rules replaced the provisions of section 83ZA of FA 1989. Paragraph 4 of Schedule 17 provided transitional rules where a contingent loan was in place when the new rules came into effect (that is in relation to accounting periods beginning on or after 1 January 2008).

Apportionment: Foreign Business Asset

23. Paragraphs 5 to 7 provide clarification of the apportionment rules for with-profit funds set out in section 432E of ICTA. This section provides for an apportionment of life insurance company profits. The changes ensure that, where the company has foreign business, adjustments made for "foreign business assets" are made consistently.

Value Shifting attributable to transfer of business

24. The value shifting provisions at sections 29 to 34 of TCGA are anti–avoidance measures applicable to companies generally. Section 32 is concerned with transfers within groups at artificial values. Where such a transaction gives rise to a capital loss the anti avoidance provisions may apply to restrict or eliminate the loss. For companies generally the value shifting rules do not apply if the disposal of the underlying asset is effected within the group for bona fide commercial reasons and does not form part of a scheme or arrangements of which the main purpose, or one of the main purposes, is avoidance of liability to corporation tax

25. This exemption is not currently available to life insurance companies when they transfer business within their group. They can therefore be exposed to the effect of the anti avoidance provision, even if the transaction is commercial and has no tax avoidance motive. Paragraph 8 extends the protection currently given to other companies to Life companies involved in a commercial transfer of business, providing the relevant conditions are met.