FINANCE BILL 2003: LIFE ASSURANCE COMPANIES

DRAFT CLAUSE & SCHEDULE

EXPLANATORY NOTES

These notes supplement and explain the details of the draft legislation published on the Inland Revenue website.

At various points, the Notes raise particular issues on which the views of readers are particularly sought - these are repeated at the end.

Any responses to the draft legislation should be directed to:-

	Richard Thomas	and	Robert Peel
e-mail:	richard.thomas@ir.gsi.gov.uk		robert.peel@ir.gsi.gov.uk
tel	020 7438 6553		020 7438 6256
address	Room 5W2 22 Kingsway London WC2B 6NR		Room 5W2 22 Kingsway London WC2B 6NR

Common abbreviations used in the Notes are:-

ICTA	Income and Corporation Taxes Act 1988
TCGA	Taxation of Chargeable Gains Act 1992
FA	Finance Act
FSMA	Financial Services and Markets Act 2000
FSA	Financial Services Authority
L-TIF	Long-term insurance fund
IPRU(INS)	The Interim Prudential Sourcebook (Insurers) made by the FSA
BLAGAB	basic life assurance and general annuity business

“Life insurer” means a company carrying on life assurance business, whether or not it also carries on other insurance business.

“Allowable losses” denotes losses on the disposal of assets within the meaning of TCGA

References to a Form are to a Form in the periodical return made under Rule 9.3 IPRU(INS)

Clause 1

1 This is simply a paving clause to introduce the Schedule

Schedule 1

2 The Schedule sets out the operative legislation. Its format generally follows the order in which various measures were described in the 23 December Explanatory Note. The final order in the Finance Bill 2003 may be different.

Background: life assurance company taxation

General

3 In most cases, a life insurer is charged to corporation tax otherwise than in accordance with the provisions of Case I of Schedule D, the Case which would naturally apply to the profits of a trade, which all insurance is. Instead the charge is on income falling within the other cases (III, V & VI) of Schedule D and Schedule A, and the chargeable gains, with relief for expenses of management. This is the I (income and gains) minus E (expenses) basis.

4 The rationale for charging a company on this basis is that it taxes, in one sum, both the income (and gains) that accrue for the benefit of policy holders (to be paid out to them in their claims) and those that are retained by the company as the profit of its business. A Case I computation on the other hand would allow a deduction for the annual increase in the liability of the company to its policy holders which would more or less match the amount of income (and gains) accruing for the policy holders.

5 That the I minus E result performs this dual function has been recognised in various ways over the years by legislation[1]. Since 1940 the rate of income tax, and then corporation tax, on that part of the I minus E result which could be said to represent the policy holders' share was charged at what was known as the "pegged rate" – a rate of 7s 6d in the £ (37.5%) – whenever the standard rate of income tax, and then the rate of corporation tax, exceeded that figure. This "pegged rate" disappeared in 1986 when the rate of CT fell below the basic rate of IT.

6 For some years after 1973 the policy holders' share of chargeable gains was distinguished from the policy holder income to be charged at a different rate – the last manifestation of this rule being in section 435 ICTA .

7 In 1989 the special rate of CT on the policy holders' share of profits was restored. Section 88 Finance Act 1989 specifically provides that the policy holders' share of the "relevant profits" (a phrase defined in section 88(3) to mean essentially the I minus E result) is to be charged at a rate of CT deemed to be the rate at which IT is charged at the basic rate. Section 89 Finance Act 1989 explains how to calculate the policy

---

[1] The principle of the I - E system was also recognised when a charge to tax on policy gains was introduced in 1968 (now to be found in sections 539ff ICTA). Until 1972/73 this was a charge to surtax only. From 1973/74 in the case of an individual the charge was to income tax at the excess of the higher and additional rates of tax over the basic rate, and consequently there was no charge at the basic rate of income tax, in recognition that tax had already been charged by proxy on the policy holder through the I minus E mechanism.

holders' share. This is done by taking what would be the Case I profit if the company were so charged, adjusting it for distributions from UK companies (which are included in a life insurers' Case I profit by virtue of section 434(1) ICTA – but not included in relevant profits) and deducting the adjusted amount from the relevant profits. This mechanism explicitly recognises that the shareholders' share of the I – E result is equivalent to its trading profit.

Case I profits

8 Although the profits from life assurance made by most life insurance companies are computed on the I minus E basis, it is still necessary to compute the profits of all or parts of their life assurance business using the provisions of Case I of Schedule D (computation of profits of a trade) for various purposes, including:

- section 89 FA 1989 (see paragraph 7) to determine how much of the I minus E profits are shareholders' profits (charged at normal corporation tax rates) and how much are policy holders' profits (charged at reduced rates of corporation tax equal to the basic and lower rates of income tax)
- section 76(2) ICTA to set a floor below which any relief for management expenses cannot be allowed to reduce the I minus E profits
- loss relief - section 434A(2) ICTA
- assessment in those rare cases, including pure reinsurers by virtue of section 439A ICTA , where the company is assessed on an actual Case I basis rather than the I minus E basis
- sections 436, 439B & 441 ICTA to calculate the profits of pension, ISA, life reinsurance and overseas life assurance business.

9 All life insurance companies are required to draw up a "revenue account" for the purposes of their return under the Financial Services and Markets Act 2000 (FSMA) to the FSA[2] in which they record investment income and gains, premiums, claims and expenses.

10 The rules in section 83(2) Finance Act 1989 provide, in effect, that it is only the gains or losses on investments as disclosed in the revenue account which are to be included as receipts in Case I computations, for the period in which they are so disclosed (and no other). A characteristic feature of most funds conducting with-profits business (business where the policy holder may participate in the established surplus arising to the company - usually by way of bonus) is that for the purposes of determining surplus, assets are not taken into account at market value (as is generally required for the purposes of testing solvency) but may, by election, be taken into account in accordance with their book value. The effect of this is that appreciation or depreciation in asset values is only recognised indirectly in the Form 40.

---

[2] The requirement is in rule 9.3 of the Prudential Handbook (Insurers), made by the FSA under the powers in FSMA

11 If there is no election to use book value (which is the case with companies writing only non-participating including linked business) the revenue account in Form 40 can be seen as a form of semi-cash flow statement into which premiums, investment income and gains (including unrealised gains) are shown as credits and expenses and claims paid as debits, the balance being the “closing fund” which in such a case would have a value equal to the market value of the company’s assets held in connection with its life assurance business.

12 But if there is an election to use book value (which is almost always the case with companies writing only participating business) companies are able to defer recognition of investment gains and asset appreciation (in terms of increases in market value) until they are reflected in changes in book value. This facility to use book value is part of the smoothing mechanism under which with-profits business has traditionally operated in the UK. Companies do not wish to distribute as bonuses (and, if not mutual, dividends) all the profits from investment income and gains made in a year as some may need to be kept back to bolster the profits of a later less prosperous year.

13 But it is an unusual company that can meet its policy holders’ reasonable expectations as to bonuses, and thus its shareholders’ expectations of dividends, purely from investment income. So in most cases the company recognises some or all of what is described in Form 40 “increases in the value of non-linked assets brought into account”: whatever amount is needed to cover such part of its claims and bonuses as cannot be met from investment income and premiums less expenses and still leave a surplus for shareholders. It is only when this recognition takes place that the amounts, as entered on Form 40 (at line 13), are “brought into account” within the meaning of section 83(2) FA 1989. If the company wants to pay more bonuses (and accordingly[3] make bigger distributions to shareholders) it must recognise a larger amount at Form 40 line 13 to fund them. But the result of this smoothing mechanism is that a lot of gains may accumulate untaxed (for Case I purposes) in what has come to be known as “the investment reserve”. The value of that “reserve” – the difference between market value and book value, can be seen from the entry in Form 14 line 51.

---

[3] Accordingly, because under the constitutions of most companies writing participating or with-profits business, distributions to shareholders are limited to a fraction of the profits declared or distributed as bonuses to policy holders – the usual figure is one-ninth, so that the profits are divided 90:10.

Paragraphs 1 to 4: Chargeable gains and allowable losses

Paragraph 1: ring fencing

14 This paragraph gives effect to the rules on "ring fencing" of allowable losses and chargeable gains described in paragraphs 1 to 3 of the 23 December Note.

Background

15 Because of the basic principles underlying the I minus E basis of taxation, a clear distinction is made in much life assurance tax legislation between the policy holders' interest in the taxable profits of the company and the shareholders' interest. There are two types of "ring fencing" which reflect a more precise and a less precise identification of the respective interests. In some cases the distinction is between what is in the long-term insurance fund and what outside it. Examples are the restriction on the use of management expenses and amounts treated as such expenses, and section 440(3) ICTA which prevents section 171 TCGA (no gain/loss transfer) applying where the asset ceases to be, or becomes, an asset of the L-TIF.

16 The more usual distinction is one that separates the shareholders' share of the profits of the relevant business (the business of life assurance) from the policy holders' share. The shareholders' share then receives the same tax treatment as any other profits of the company arising from activities other than life assurance. The basic rule here is that in sections 88, 88A and 89 FA 1989, which determine the tax rates applicable to each part. A further important ring fencing rule is section 434A(3) ICTA which prevents loss relief, group relief and non-trading loan relationship deficits from outside the life assurance business from being set off against the policy holders' share of profits.

17 There is however no explicit rule which prevents a set-off of allowable losses arising from disposal of assets held outside the L-TIF against the policy holders' share of chargeable gains from L-TIF assets. Nor is there any explicit rule preventing a set off of allowable losses arising from disposal of assets held within the L-TIF from being set against gains arising on assets held outside that fund. It may be inferred from the structure of section 88(3) FA 1989 (as substituted by Schedule 8 FA 1995) that the policy holders' share of gains, or all L-TIF gains, cannot be the subject of a deduction for losses accruing on gains from the disposal of non L-TIF assets, but the point is not clear cut.

Detail

18 Paragraph 1(1) clarifies any ring fencing rules for chargeable gains and allowable losses by inserting a new section 210A into the Taxation of Chargeable Gains Act 1992.

19 Section 210A(1) sets out the rule where allowable losses (within the meaning of that Act) accrue on assets which are not assets of the L-TIF. Any such losses may not be deducted from the policy holders' share of chargeable gains accruing[4] on the disposal

---

[4] Note that "accrue" in the TCGA is used in the sense of arise, and not in the accounting sense.

of assets of the L-TIF. They will be deductible from the share holders' share of any gains. Non L-TIF losses will therefore not interfere with the calculation of the policy holders' share of relevant profits on which a reduced rate of corporation tax is charged.

20 Section 210A(3) defines the "policy holders' share" of gains. It follows the usual definition based on the fraction given in section 89(3) FA 1989 where the shareholders' share is the fraction A/B, A being the Case I profit of the life assurance business, and B being the investment return disclosed in the FSA return for that business.

21 Section 210A(2) is the converse of the rule in section 210A(1). But it goes further and denies the possibility of deducting any losses accruing on the disposal of L-TIF assets from gains accruing on non L-TIF assets. In paragraph 3 of the 23 December Note it was suggested that only the policy holders' share of losses would be incapable of being so deducted. But it has proved very difficult to find a way of calculating the policy holders' share of losses that is both fair and simple. This is because losses may be carried forward from period to period, and in each period the policy holders' share, computed as in section 210A(3), would be different. And if the shareholders' share of losses has been deducted from non L-TIF gains, it would be inappropriate to re-apply a fraction to the amount carried forward when it consisted entirely of policy holder losses.

22 Readers are invited to suggest any ways that occur to them of finding a way of allowing only the shareholders' share of losses to be deducted from non L-TIF gains that is both fair to the Exchequer and does not involve complicated tracking rules and compliance costs.

23 Section 210A(4) makes it clear that the losses that cannot be deducted include losses that accrued in periods before the legislation has effect, and takes account of the fact that the L-TIF was formerly called the long term business fund ("LTBF").

24 Section 210A(5) gives definitions based on those appearing in section 431(2) ICTA.

25 Paragraph 1(2) gives the commencement rule. Losses subject to the section may not be set against gains accruing on or after 23 December 2002.

Paragraph 2: Bed & breakfasting

26 This paragraph gives effect to paragraph 10 of the 23 December Note.

Background

27 Section 106 TCGA is the rule that was introduced as section 58 Finance (No. 2) Act 1975 to discourage the practice of bed and breakfasting, that is selling shares standing at a loss by reference to their base cost and buying them shortly afterwards, often the next day. It also prevents companies reproducing the same effect by "double banking" - buying similar shares shortly before a sale. The section operates by identifying shares disposed of with shares acquired in a "prescribed period", which is, for deals on a Stock Exchange, 30 days before and 30 days after the acquisition (same day transaction are identified under a different rule). The section requires acquisitions by other group members to count as acquisitions by the disposing company, but does not apply unless the holding of shares amounts to 2% or more of the issued share capital.

28 When it was introduced section 58 applied to assets held in connection with life assurance business in the same way as it applied to other assets of life insurers and of other companies. In 1990, as part of the major reforms of life assurance company taxation in that year, life insurance companies were excluded from the section, so far as their life assurance assets were concerned. Since 1990, companies have continued to practice “bed and breakfast” manoeuvres but using the “internal” route exploiting the rules in section 440 ICTA instead. This is cheaper (no stamp duty or dealing costs) and safer (no market risk). This avenue is now being cut off (see notes on paragraph 3 of the Schedule), so it is necessary to discourage companies from seeking to return to “external” bed and breakfasting.

Detail

29 Paragraph 2(1) therefore inserts an new section 106(3A) into TCGA. That subsection glosses the term “trading stock” which is defined in section 288(1) TCGA and section 100(2) ICTA and which would cover assets held in connection with life assurance business even though any gains are not brought into account in a trading profit computation under Case I of Schedule D. Trading stock generally will remain outside section 106, but not where it is held in connection with life assurance business.

30 There is an exclusion for “section 212 assets”. These are holdings in some authorised unit trusts, OEICs and offshore funds. Those assets are the subject of an annual deemed disposal so there is little point in applying section 106 to them.

31 There is also an exclusion for deemed disposals under section 440 (see notes on paragraph 3 below). They will now be subject to their own anti “bed and breakfast” rule.

32 Although it has been suggested that the 2% limit in section 106 might be reduced for assets held in connection with life assurance business, the 2% limit is retained in the published draft.

33 The new section 106(3A) also gives definitions, using section 431(2) ICTA as the dictionary.

34 Paragraph 2(2) gives the commencement rule. Section 106 will apply to disposals on or after 23 December 2002 (the date of announcement).

35 Readers are asked to say whether reintroducing life assurance companies to section 106 would give rise to major difficulties, particularly in compliance. They are asked to suggest, if they think it appropriate, alternative methods of discouraging bed and breakfast which would be simpler to operate but which would be as effective.

Paragraph 3: Deemed intra-group transfers

36 This paragraph gives effect to the proposals on “internal” bed and breakfast transactions (“Box” transfers) described in paragraphs 6 to 9 of the 23 December Note

Background

37 Section 440 ICTA was substituted in 1990 for a previous version and was intended to do a number of things. It threw a ring fence around the L-TIF so that the no gain/no loss transfer rules in section 171 TCGA did not apply to transfers into and out of the LTBF, now the L-TIF. (See notes on paragraph 4 below for further measures concerning section 171 transfers).

38 It also carved the L-TIF up into a series of "boxes", as they have come to be known, together with a box consisting of assets held outside the L-TIF. This was to prevent companies taking advantage of the fact that for some categories of business, a gain or loss on the disposal of the assets referable to them was exempt. This applies in particular to assets held to back pension business. Without section 440, an asset pregnant with gain might, by the stroke of a pen or the press of a button on a computer keyboard, cease to be one on which a gains would arise. Conversely, an asset standing at a loss but in circumstances where the loss was not allowable, could be moved into an allowable loss category.

39 Section 440 as substituted in 1990 provides that if an asset was treated in the books and records of the company as having moved from one box to another, there was deemed to be a disposal (and re-acquisition) of it for the purposes of the Corporation Tax Acts (not just for chargeable gains purposes).

40 Some companies discovered that if they transferred an asset standing at a loss from one (taxable and hence allowable) category to another, and then next day re-acquired it in the original box, the deemed disposal would trigger an allowable loss, but that box would still have, after a few hours delay, the same asset available to it.

41 With the bull market of the late nineties the stock of assets standing at a loss diminished, but the bear market of the last few years has replenished the stock of such assets. In order to put a stop to increased activity in this area, paragraph 3 inserts a section 440ZA into ICTA. It is modelled on a similar rule appearing in section 320-255 of the Australian Income Tax Assessment Act 1997.

Detail

42 Section 440ZA(1) gives the case for the operation of the section. It applies where there is an allowable loss accruing as a result of a box transfer within section 440. There will only be such a loss if the box out of which the assets moves is one of those described in section 440(4)(d), (e) or (f).

43 Section 440ZA(2) is the operative rule. The loss is only capable of being deducted from a chargeable gain of any sort in a relevant accounting period or a later one. Section 440ZA(3) defines a relevant accounting period as one during which all or part of the asset on which the loss accrued is disposed of in a "qualifying disposal".

44 That term, in turn, is defined in section 440ZA(4) to mean a disposal which is

- Not a disposal to a fellow group member (where "group" has its section 170 TCGA meaning - section 440ZA(5))

- Not a no gain/no loss disposal in the course of a Part 7 transfer, that is one to which section 139 TCGA applies only by virtue of section 211.

45 The disposal outside the group which allows the loss to be deducted does not have to be by the life insurer. In a case where there is a transfer to another group company or a Part 7 transfer, the loss is not released at that point, but where the transferee (or further successor as a result of further group or Part 7 transfers) disposes of the assets in circumstances which do not fall within section 440ZA(4)(a) or (b), the loss is released to the insurance company which made the original loss under section 440.

46 Readers are asked to consider whether there should be a rule which permits the loss released to be available to a transferee under a Part 7 transfer, particularly where the original company has ceased to carry on business as a result of the transfer.

47 Section 440ZA(6) deals with the case where the asset or part of the asset (for example a part of section 104 TCGA holding of shares) disposed of in a box transfer is not entirely disposed of in the later disposal outside the group. The loss released by the subsequent disposal is a proportionate part of the whole loss, based on the proportion of values of the part disposed of in the subsequent transfer and the value of the entire assets or part at that time.

48 For example:-

> Suppose that on 30 6 2003 the company had a holding in its category "solely linked BLAGAB" (which by virtue of section 440A(2)(d) is treated as a separate section 104 holding) of 50,000 shares in X plc. It transfers 20,000 to its category "other assets" and a loss of £40,000 accrues.
>
> Since this disposal is a disposal of part of an asset for the purposes of TCGA only by virtue of being deemed one under section 440(1), section 444ZA(1) applies to the loss of £40,000 which falls to be deducted from gains only when there is a "qualifying disposal" under section 440ZA(4). On 30 11 2004 the company disposes of 10,000 of the shares transferred to the "other assets" category to a pension fund for £5,000. The remaining shares are also worth £5,000 at that date.
>
> Of the loss of £40,000 held over, £20,000 can be released as the proportion disposed of outside the group is £5,000/£10,000.

49 Paragraph 3(2) gives the commencement rule. Section 440ZA will apply in relation to allowable losses accruing on or after 23 December 2002 (the date of announcement).

50 Readers are invited to suggest whether there are any exclusions from this rule that could be made without recreating the mischief against which it is aimed, and if so, how. For example, could transfers made to comply with the requirement of paragraph 3(1) Schedule 19AA ICTA (replenishment of the overseas life assurance fund) be safely excepted? Could transfers of section 212 assets?

Paragraph 4: Notional intra-group transfers.

51 This paragraph gives effect to the proposals described in paragraph 4 of the 23 December Note

Background

52 Section 171A TCGA was introduced in FA 2000. Before its enactment there was no form of group relief for allowable losses within the meaning of TCGA. Instead there was a well known practice of transferring an asset from one company (A) to another in the group (B) using section 171 TCGA which provides that a transfer between two companies in the same group is treated as made for a consideration which gives neither a gain nor a loss – a “tax neutral transfer”. B then transfers the asset to C which will be a company outside the group and to which A would, but for the lack of a group relief system for gains, have sold directly. The object of the intermediate sale to B would be to ensure that a gain that would otherwise have been made by A, but which would have been subject to tax, is instead made by B which has allowable losses to set against it – or vice versa.

53 Section 171A was enacted to remove the necessity of making an actual transfer with its attendant costs. Instead A and B can jointly elect that there is deemed to be transfer by A to B followed by an immediate sale by B to C. However, it is a condition of the election being successfully made that if there had been an actual transfer from A to B section 171 would have applied.

54 For most companies this condition is clearly capable of being fulfilled by simply providing that A and B are in the same group. But section 171 only applies in very limited circumstances where a life insurer is concerned. Section 440(3) ICTA provides that section 171 does not apply to a transfer of an asset held in a company’s L-TIF, or to a transfer to a company’s L-TIF. In the case of a mutual life insurer all its assets will be in its L-TIF. In many other cases the overwhelming preponderance of assets will be so held.

55 It is therefore impossible to say that in a case where company B is a company with a L-TIF that section 171 would have applied to an actual transfer from A to B.

56 There is no policy reason why section 171A should not apply to a transfer to a life insurer so long as the integrity of section 440(3) and of the new section 210A(1) (see notes on paragraph 1 above) are not impugned.

Detail

57 Accordingly, paragraph 4(1) and (2) amends the TCGA by inserting a new section 171A(3A) into that Act.

58 That new subsection relaxes the prohibition in section 171A(3) where B is an insurance company. An election may now be made by an insurance company B (with A) but the effect of the election in such a case is that the asset is treated as being held for the deemed moment before the sale to C otherwise than in the company’s L-TIF.

59 The second sentence of new section 171(3A) also gives definitions, using section 431(2) ICTA as the dictionary.

60 Example

Suppose that on 1 January 2002 A plc holds shares in Z Ltd which would if sold give rise to an allowable loss of £100 million. A Life Ltd has chargeable gains of £50 million expected to accrue in 2002 and a similar amount in 2003.

If A plc transferred the shares in Z Ltd to A Life Ltd (but not so that the shares became assets of its L-TIF) in a section 171 transfer, and A Life Ltd then sold the shares in Z Ltd outside the A plc group, A Life Ltd would have an allowable loss of £50 million.

If however A plc and A Life Ltd purported to make a section 171A election to avoid the cost of the intermediate transfer it would not be valid.

If however the disposal outside the group occurred on or after 23 December 2002, A plc and A Life Ltd could make a valid election, the shares in Z Ltd would be deemed to be transferred to A Life Ltd but not so as to become an asset of its L-TIF, and the allowable losses of £50 million would be available to A Life Ltd subject to section 210A(1) TCGA.

61 Paragraph 4(3) makes a minor consequential amendment to section 171A(4) and paragraph 4(4) gives the commencement rule. Section 171A(3A) will apply in relation to disposals (to C) on or after 23 December 2002 (the date of announcement).

Paragraphs 5 and 6: Case I profits

Background: general

62 Paragraphs 8 to 13 of these notes describe the basic operation of the Case I rules for life assurance business, and how gains on assets of the L-TIF are brought into account in the FSA return and taken into account for CT purposes.

63 It has become increasingly apparent that companies have been looking for ways to extract untaxed gains (or rather an amount of assets representing them) in such a way that the gains do not have to be recognised for tax purposes by passing amounts through the revenue account.

64 Companies have also realised that if they use assets (including cash) to pay expenses or to discharge liabilities in a way that is not reflected in the revenue account and if those expenses or payments would not fall to be deducted in a Case I computation if they were shown in the revenue account, then this is tantamount to getting an unwarranted deduction for them, because the amount needed to be recognised in line 13 to balance the surplus is reduced.

65 Many of these manoeuvres (but not all of them) involve the company transferring its long term business to another company or companies under a scheme approved by the Court in accordance with Part 7 FSMA (previously Schedule 2C Insurance Companies Act 1982). Many such schemes are driven by commercial considerations, such that the extraction of untaxed gains is a fortunate by product, but it is also not difficult to arrange an intra-group transfer specifically to enable extraction of untaxed gains.

66 Where there is a Part 7 FSMA transfer of business, then normally all the assets and all the liabilities of the transferor are passed over to the transferee. Where there is at the date of the transfer an excess of market value of assets over book value (the so called investment reserve), then assets representing in value the amount of that excess will normally be transferred so as to become an investment reserve of the transferee. Other assets of the transferor held and disclosed in the long-term insurance fund of the transferor will equally be shown as arising in the fund of the transferee, usually by being reflected in line 15 of Form 40.

67 Where assets move from the investment reserve of the transferor to become the investment reserve of the transferee, then nothing has been lost: changes in value of those assets as recognised in Form 40 line 13 of the transferee will still emerge in the ordinary course of events. But where assets equal to the amount of the investment reserve of the transferor are either retained by the transferor, or are transferred to the transferee in such a way that they do not become (part of) the investment reserve of the transferee, then the opportunity to bring the gains into the revenue account of the transferee is forever lost.

68 It may happen that the transferee cannot afford to be without assets equal in value to the transferor's investment reserve. What may happen here is for the assets to leave the transferor, go to the transferee but outside its L-TIF and then to another group company (or go direct to another group company) which then "lends" the money to the transferee on terms that ensure that the repayments of the loan are not brought into account through the revenue account of the transferor.

Paragraph 5: policy holders' bonuses, tax etc.

69 This paragraph gives effect to the proposals in paragraphs 15 and 16 of the 23 December Note. It rewrites section 82 FA 1989, and divides it into two.

Background

70 Section 82 was introduced as part of the major reforms of life assurance taxation in 1989 and 1990. Norman Lamont, then Financial Secretary to the Treasury, described the purpose of the legislation. He said—

> "The object is to ensure that there is proper matching between the deductible bonus allocations and liabilities to policy holders, on the one hand, and the incomings which fund those liabilities on the other……The main effect of the clause [now s 83 FA 1989] is to ensure that taxable incomings and deductible liabilities follow the figures in offices' own accounts, thus ensuring internal consistency and a proper balance between credits and debits".
>
> Hansard: Standing Committee G cols 368/9 8 June 1989.

71 Section 82 replaced a rule which had come to be known as the "reservations" rule, latterly found in section 433 ICTA, but dating back to section 53 FA 1920 applying to the long obsolete Corporation Profits Tax. Despite its antiquity and brevity, there had never been any wholly satisfactory agreement about what it meant. Section 82 put it beyond doubt that there were only two items which could be deducted in a computation of profits made under the provisions of Case I of Schedule D that arguably were not permitted by those provisions. The two matters were tax and bonuses.

72 Bonuses payable to policy holders in cash or as reductions of premiums were a common feature of life assurance in the 19th century. In time reversionary bonuses, declared at the end of a year but payable only on termination of the policy became the overwhelming norm, and in the second half of the 20th century terminal bonuses, paid on termination at the discretion of the company began to be common, usually payable out of investment growth that companies experienced as they invested more in equities.

73 A case heard by the House of Lords in 1885, *Last v London Assurance Corporation* 2 TC 100, showed that cash bonuses, premium reductions and amounts added to sums assured (reversionary bonuses) were not a deduction in computing profits for the purposes of Case I of Schedule D. But Section 433 and its predecessors did permit allocations of profit to policy holders to reduce profits. Section 82 continued this and made it explicit that a deduction was due in a Case I profit computation, in the case of reversionary bonuses by adding the present value of them to the closing figure of liabilities. It was thus implicit from this that the starting point for a Case I computation of

life assurance business was the figure of surplus for the year after distribution of surplus to policy holders.

74 Section 433 also permitted amounts reserved for policy holders to reduce profits as well as amounts allocated as bonuses. This concept was generally removed from tax legislation, but a remnant remained in the shape of section 82(1)(b), (3) and (4) FA 1989. This allowed a company which had an unappropriated surplus to add to its closing liabilities an amount (so long as it exceeds all previous reservations under section 433 and its predecessors) that was shown to be necessary to meet the reasonable expectations of policy holders. The relief was designed to accommodate a very small number of companies which wrote with-profits business, but which did not take advantage of the ability of a company to elect to use book value of assets if lower than their market value in arriving at the surplus of a period. The use of a book value election to build up an "estate" to enable a company to satisfy with-profits policy holders' reasonable expectations is commonplace in insurance in the UK.

75 It now appears that the only companies which have used the section 82(1)(b) relief are closed to new business. It can be expected therefore that the amount of surplus available for relief will decline as business goes off the books. In those circumstances, subsections (1)(b), (3) and (4) of section 82 disappear as the rewritten section 82 does not include them.

76 Although section 82(1)(b) and related provisions are effectively repealed by the current draft, the need for transitional measures will have to be considered along with any representations that some measure of relief should be retained for companies that have previously claimed relief. Readers are asked to give their views on what might be appropriate here.

Detail

77 Paragraph 5(1) substitutes a new section 82 for the existing one.

78 Section 82(1) provides the case for itself and section and the new section 82A (see below) and reproduces the effect of the previous section 82(1), that it applies where a computation of a company's life assurance profits are made in accordance with the Case I provisions. Such a computation is made for a number of purposes (see paragraph 8)

79 Section 82(2) makes amounts allocated to policy holders or annuitants allowable deductions in a Case I computation. The wording of the relief is updated to follow the style of the Tax Law Rewrite and other recent tax provisions. The subsection replaces the previous section 82(1)(a), except in relation to tax (see section 82A below)

80 Section 82(3) defines what is meant by "allocated" in a variety of circumstances:-

- Cash (including terminal) bonuses are allocated if payments are made – paragraph (a)
- Reversionary bonuses are allocated if declared – paragraph (b)
- Reductions in premiums are allocated if a reduction is made – paragraph (c)

and not otherwise, so a provision for a bonus made before declaration, payment or reduction is not allowable as a deduction (following *Last's* case)

81 This subsection replaces the opening words, and paragraphs (a) and (b), of the previous section 82(2).

82 Section 82(4) explains what is the amount of the allocation that may be allowed as a deduction. In the case of payments of cash bonuses it is the amount of the payment. In other cases it is the amount of liabilities (known as mathematical reserves) assumed as a result of the declaration or reduction. This is the amount that appears in the periodical return made to the FSA on Forms 58 and 60. This subsection replaces the fullout words of the previous section 82(2).

83 As a result of the replacement of section 82, the complex transitional rules in section 82(5) to (8) which applied to a period straddling 13th March 1989 disappear.

Background

84 Section 82A is also inserted by paragraph 5(1). This provides an allowable deduction for tax expended on behalf of policy holders. The need for such a rule derives from the method used in the UK to charge to tax income and gains accruing to a life insurer for the benefit of policy holders under the so-called I minus E method - see paragraph 3 onwards.

85 Given that tax is charged on income which will go to policy holders when their policies pay out (and is reflected in the basic rate credit given by section 547 ICTA), it is as much an allowable deduction in computing a profit under Case I rules as claims paid, and liabilities assumed to policy holders. If the issue were being approached anew, in the light of section 42 FA 1998, it is likely that the deduction for policy holders' tax would be taken for granted, there being no obvious rule of tax law to prevent it.

86 Matters were not so clear cut in 1920 however when a new tax was being enacted, and a provision was brought in then which allowed amounts expended on behalf of policy holders to reduce profits. Although tax was not mentioned, there is no doubt that tax, and only tax, was what the rule was aimed at, and this was finally made explicit in section 82 FA 1989 when enacted.

87 Nothing in section 82 as enacted explained though what was meant by the amount of tax expended on behalf of policy holders. It has not proved easy to reach agreement about what it does mean. Various methods are used from simply grossing up the Case I profit at the ruling rate of mainstream CT to the employment of various formulae.

Detail

88 Section 82A is designed to end these disputes and differences in practice.

89 Section 82A(1) sets out the operative rule. Tax (which means UK corporation tax together with any vestigial amounts of income tax deducted at source and not repaid, or set off under Schedule 16 ICTA, but not foreign tax) expended on behalf of policy holders or annuitants in respect of a period of account is allowable as a deduction. But this is qualified now so that only the amount as determined by regulations is so

allowable. This subsection replaces the previous section 82(1)(a) FA 1989 so far as it related to tax.

90 Section 82A(2) is an extension of the existing rule, and is connected with the new section 83(2B) FA 1989 (see paragraph 6 of the Schedule). It is the practice of some companies not to charge certain amounts of tax in its revenue account (Form 40 of the FSA return). Such tax does not clearly fall to be deducted under the previous section 82. But with the enactment of section 83(2B) bringing all tax not so charged into account as a receipt, it is only fair to allow as a deduction the policy holders' tax thus brought into charge. The regulations will provide how the amounts are to determined.

91 Section 82A(3) is a boilerplate provision allowing the regulations to make different rules for different cases and to have effect for periods in which they are made. This is necessary because section 82A will only come into force on Royal Assent of Finance Act 2003, and until it does, no regulations can be made. When made they will have effect for the same periods as the new section 82A and paragraph 5 generally.

92 Readers are invited to suggest what approach(es) the regulations should take. It is hoped to have a draft of any regulations available by the time the Finance Bill is published.

93 Paragraph 5(2) and 5(3) makes consequential amendments.

94 Paragraph 5(4) gives the commencement rule. Both sections 82 and 82A will apply to periods of account beginning on or after 1 January 2003. More than 90% of life insurance companies have calendar year periods of account and financial years for regulatory purposes.

Paragraph 6: Case I profits etc. receipts to be taken into account

95 This paragraph gives effect to the "main" proposal described in paragraphs 11 to 14 of the 23 December Note, except the third and fourth bullet points in paragraph 12 (as to which see the note on paragraph 9).   The paragraph amends section 83 FA 1989.

Background

96 Section 83 was the other pillar in the special measures of computation of Case I profit of life assurance introduced in the 1989/1990 reforms. It was designed to equate the investment return brought into account in that computation with the amounts shown as investment return in the then DTI regulatory return, now the FSA return - see the quotation from Hansard in paragraph 70. But its interpretation has not been free from doubt, and challenges are being made to the Revenue's interpretation which if successful would seriously undermine the integrity of the Case I rules. Paragraph 6 therefore puts the interpretation of section 83, and subsection (2) in particular beyond argument. It also deals with attempts to side-step section 83(2) by not reflecting in the revenue account amounts which would normally fall to be so reflected, such as tax which would normally appear in the revenue account at Form 40 line 24.

97 It also deals with extractions of profit from a company which are not reflected in a computation of profits drawing on entries in the revenue account. This needs further explanation.

98 The rules for computing Case I profits for life insurance companies are unique in a number of ways, most particularly their treatment of gains on the appreciation and realisation of investment assets. The Case I profits of life companies are also based on the surplus shown in the company's periodical return deposited with the FSA so that the company's solvency position can be monitored. This contrasts with the position for other trading companies which have their Case I profits based on their statutory accounts completed in accordance with the Companies Act 1985 - see section 42(1) and (5) FA 1998.

99 In the case of many life companies, an election may be made under Rule 4.1(6) of IPRU(INS) (previously regulation 45(6) Insurance Companies Regulations 1994) to use book value rather than market value in determining surplus. Paragraphs 9 to 13 describe how that mechanism is used to defer recognition of value changes in assets and explain that companies have a substantial discretion as to how much is included in the entry in line 13 of Form 40, so long as it contains a large enough amount to enable a company to declare and pay bonuses and where relevant to transfer sums of surplus to be available for distribution to shareholders in the amounts it wishes to show.

100 It follows that if amounts are brought into account in the revenue account but are not taken into account for tax purposes, they "fill the hole" in the computation of surplus that could, in circumstances where the investment reserve (the excess of market value over book value (Form 14 line 51)) is sufficient, be filled by an entry in line 13 of Form 40 which would be a trading receipt by virtue of section 83(2). Some hole filling amounts of this type are repayable but only if there is sufficient surplus to pay them – these included contingent loans and advances from reinsurers in financing arrangements. Where the receipt of amounts of this sort have depressed the taxable surplus, it is proposed that on repayment the amounts will be brought into account as additional trading receipts.

101 As mentioned above, the amendment to section 83 also brings into account amounts of expenditure such as tax which would otherwise be reflected in the revenue account. If they had been reflected there, that would have reduced surplus so as to require a compensating additional amount in Form 40 line 13. By not being reflected in the revenue account, the line 13 amount required to balance the revenue account is *pro tanto* smaller, and if the expenditure is not deductible on normal Case I principles this manoeuvre effectively allows a deduction.

Detail

102 Paragraph 6(1) replaces section 83(2) FA 1989 with seven new subsections.

103 Section 83(2) – new version – is similar to the previous version. But the reordering of the opening words, taken with the fullout words of section 83(2A), makes it clear that what is taken into account as trading receipts (or expenses if negative) are the amounts contained in lines 12 to 15 of Form 40. Those lines are the lines whose description is set out in paragraphs (a) to (d) of section 83(2). They include now for the first time line 15 ("other income"). This change is not intended to suggest that items previously shown at line 15 did not fall to be treated as trading receipts, either because they fell within the current wording of section 83(2) or on ordinary Case I principles.

104 Section 83(2A) sets out the only exclusions permitted from the effects of section 83(2). One is notional amounts such as credits for notional rents. Some companies which hold their own offices as assets of their L-TIF credit a “rent” in line 12 of For 40 and make a corresponding deduction in line 22 (expenses). These credits are not taken into account; nor are the expenses.

105 The other is amounts falling within section 444AC(2) ICTA – see notes on paragraph 9(1) below.

106 The fullout words reinforce the message in section 83(2) that there are no other exclusions irrespective of any exemption or relief from tax that might be given by other provisions of the Tax Acts.

107 It is not however intended to require to be taken into account credits under a debtor loan relationship within the meaning of Chapter 2 Part 4 FA 1996. It is not clear whether paragraph 2(2) to (5) Schedule 11 FA 1996 read with section 80(5) of that Act achieve that. **Readers are asked to say whether any, and, if so, what further amendments to either section 83 FA 1989 or Chapter 2 Part 4 FA 1996 are necessary to achieve the desired outcome.**

108 Section 83(2B) brings into account as amounts within section 83(2) payments of cash and the fair value of assets transferred not reflected in the revenue account, unless they are excluded by section 83(2D) or (2F) or section 444AD ICTA (see notes on paragraph 9 below).

109 “Fair value” is defined in section 83(2C) and has the normal accountancy meaning such as that given in Chapter 2 Part 4 FA 1996 (loan relationships) and Schedule 26 FA 2002 (derivative contracts).

110 Section 83(2D) gives one of the exclusions from section 83(2B). It excludes repayments of deposits from reinsurers in normal deposit back arrangements; the discharge of debenture loans and loans from banks. These are liabilities that appear in lines 21 to 41 of Form 14 (Long-term business liabilities and margins), the liabilities side of the balance sheet in the FSA return.

111 Repayments of contingent loans and advances are not excluded. Although such repayments would be shown in Form 14 once the liability to repay has crystallised if a periodical return containing Form 14 was drawn up ending with a date between the crystallisation of the liability to repay and the payment, section 83(2D)(b) ensures that they do not fall to be excluded. **The Inland Revenue recognises that there is a case for treating repayments of contingent loans and advances differently according to the accounting treatment of the principal received when the loan was made. The Inland Revenue will be pleased to discuss the most appropriate basis for distinguishing different treatments of such loans, and readers are invited to make representations on this point accordingly.**

112 Section 82(2E) defines “periodical return” using section 431(2) as a dictionary.

113 Section 83(2F) also excludes amounts if they are either the payment of the purchase price of investments or the disposal of such investments. This rule reflects Rule 3.2(4) of IPRU(INS) (previously section 29(4) Insurance Companies Act 1982).

114 Paragraph 6(2) makes a minor correction

115 Paragraph 6(3) provides for the amendment of, and paragraph 6(4) and(5) amends, section 432E ICTA in consequence of new section 83(2B).

116 Paragraph 6(4) inserts a new section 432E(2A). This allows any amounts taken into account as amounts within section 83(2) by virtue of section 83(2B) to be added to the "net amount" of investment return established by the "needs basis" calculation in section 432E(2).

117 The amount attributed to each category of business is found by a simple fraction, based on the one used in section 432E(2) (and in the section 432E(2A) treated as inserted by SI 1997/473 in the case of a friendly society carrying on life or endowment business – which will be renumbered in due course by regulation). The numerator is the bonuses of the category, and the denominator the total bonuses.

118 Paragraph 6(6) gives the commencement rule. The amendments to section 83 and to section 432E ICTA will apply to periods of account beginning on or after 1 January 2003.

Paragraphs 7 to 13: Transfers of insurance business

Background: business transfers

119 In the absence of special provisions, if a life insurer wished to transfer its business or part of its business to another such company, there would be substantial difficulties and inconvenience involved. This is because, under English law at least, it is not possible to transfer liabilities without the consent of the creditor. Since a life insurer has in many cases thousands if not millions of creditors in the shape of policy holders, obtaining the consent of all them would be very difficult. Accordingly there has long been a process under which transfers of business could be made without the policy holders' consent if the transfer is sanctioned by the High Court, or in Scotland, the Court of Session.

120 The current provisions for this sanction are in Part 7 FSMA and such transfers are described in this note as "Part 7 transfers". They are still often referred to as Schedule 2C transfers, as the previous rule was in that Schedule to the Insurance Companies Act 1982.

121 In 1990 a number of special tax provisions were enacted to deal with transfers of business. Their object was primarily to provide a "stand in shoes" or tax neutrality rule where assets were transferred, and to allow carry over of reliefs which would otherwise be lost on the cessation of business of the transferor. The reliefs were intended to recognise that although the shareholder ownership of the business may have changed, the same policy holders had their interest in the business before and after, and that matters which related to the taxation of the policy holders' interest in company's income gains or profits should be unaffected by the change of company.

122 In addition, section 12(7A) ICTA was enacted to bring an accounting period of the transferor to an end where there was a transfer of business if it would not otherwise do so.

123 Some gaps and weaknesses in the tax rules concerning Part 7 transfers have become apparent. In addition some companies have used Part 7 transfers as an opportunity to ensure that income and profits escape taxation altogether. Paragraphs 7 to 13 of the Schedule prevent these tax free extractions of profit and make other changes to the Part 7 transfers tax neutrality rules.

Paragraph 7

124 This paragraph gives effect to the fourth bullet point in paragraph 18 of the 23 December Note.

Background

125 As will have become apparent from the Notes about paragraphs 5 and 6, a great many of the tax rules for life assurance companies are based on entries in the FSA return, the periodical return made to the FSA under Rule 9.3 IPRU(INS). When a company transfers its entire long term business under a Part 7 transfer, it may be excused by the FSA from depositing a periodical return for the period ending with the transfer or which straddles the transfer. This is because once a company has ceased

to carry on business, the FSA, whose prime interest is in the solvency of continuing insurers, does not need to monitor the solvency of a now ceased insurer.

126 The lack of a periodical return means that many of the figures used to make apportionments of income and gains are missing-

- Opening and closing liabilities are needed for sections 432A(6), 432C(4), 432D(3), 432E(3) and regulation 5 SI 1990/1541, paragraphs 16(2) and 17(4) Schedule 7 FA 1991 and section 255 Capital Allowances Act 2001

- Opening and closing values or net values of assets are needed for sections 432A(6), 432C(4), 432D(3), 432E(3) and regulation 5 SI 1990/1541.

- Opening and closing amounts of the investment reserve are needed for section 432A(6).

127 And the absence of a revenue account in Form 40 and of Forms 13, 14 and 58 may make it impossible to determine the Case I profit of the period.

Detail

128 Paragraph 7(1) inserts a new section 444AA into ICTA to rectify this position.

129 Section 444AA(1) gives the case. It applies where there is an insurance business transfer scheme, which is defined in section 431(2) ICTA to mean a scheme falling within section 105 FSMA, including an excluded scheme falling within Case 2, 3 or 4 of subsection (3) of that section. Section 105 relates to transfers of long-term insurance business (which includes life assurance business). The excluded cases are those where a transfer scheme does not require, but may involve, Court sanction. The section applies where there is such a scheme if the last periodical return made by the transferor company was for a period that ended earlier than immediately before the transfer. Thus whether the last return was for period ended on the day before or 18 months before the transfer, the section applies.

130 Section 444AA(2) gives the operative rule. The company is deemed to produce a periodical return for the period starting with the day following the date to which the last return was made, and ending immediately before the transfer takes place. As foreshadowed above, this period may be for two minutes or it may be for more than twelve months.

131 The deemed periodical return must contain such entries as would have been contained in an actual return made for the period. Inland Revenue guidance will indicate what particular entries will always need to be made in such a case (at a minimum they will include “dummy” Forms 13, 14, 16, 40, 41, 42, 51 to 54 and 58). There is no requirement that the dummy return be audited, or be certified by an actuary: the Inland Revenue will rely on the company’s statement on its tax return, and will obviously expect the figures in the deemed return to reconcile with, or be reconciled with, figures in the company’s Companies Act accounts for the same period.

132 The making of the dummy return is to make the period for which it is made a “period of account” of the transferor. This is important because without a periodical

return a company does not have a period of account, and it is by reference to periods of account and not accounting periods that much of the life assurance company tax provisions operate. In the case of a life insurer the “account” mentioned in the definition of “period of account” in section 832(1) ICTA is the periodical return, not the Companies Act accounts.

133 Paragraph 7(2) gives the start date. It applies to Part 7 transfers occurring on or after 1 January 2003 unless the start date of the accounting period ending with the transfer in accordance with section 12(7A) ICTA began before 1 January 2003.

Paragraph 8: charge on transferor retaining assets

134 This paragraph gives effect to the first bullet point in paragraph 18 of the 23 December Note.

Background

135 The Inland Revenue has seen cases where a company transfers its entire long-term business under a Part 7 transfer (or its predecessors) but where there are surplus assets of the L-TIF which the transferee does not require. What the transferor does is simply to leave an amount of assets behind and cease to carry on insurance business.

136 This is of no particular tax consequence if what is left behind represents undistributed surplus of the transferor, as the amounts involved will have been taken into account for tax purposes through the normal mechanisms of section 83 FA 1989. But if what is left behind represents asset appreciation not effectively brought into account through the section 83 mechanism, then that appreciation may never come into charge. It should, however, not be inferred from this that no charge will arise in a case where the transfer took place before 1 January 2003 – the point here is that with the enactment of section 444AA (see notes on paragraph 7 above) arguments based on the fact that there was no periodical return for the period will no longer be available.

Detail

137 Paragraph 8(1) inserts a new section 444AB into ICTA.

138 Section 444AB(1) gives the case. It is where immediately after a transfer of long-term business the transferor ceases to carry on long-term business but still holds assets which were L-TIF assets immediately before the transfer. Note that it is irrelevant that the company may continue to carry on general insurance business after the transfer in the case of a composite.

139 Section 444AB(2) is the operative rule. It imposes a charge under Case VI on the company for its first accounting period to begin immediately after the transfer. An accounting period will have ended with the transfer by virtue of section 12(3)(c) ICTA (cessation of trade) and a new one begun immediately after. Although the first bullet of paragraph 18 of the 23 December note suggested that this amount would be treated as a post-cessation receipt, it is not in fact to be brought within section 103 or 104 ICTA, as there seems no need specifically to invoke either of those sections.

140 Section 444AB(3) and (4) give the alternative amounts to be brought into account. Section 444AB(3) provides that if a company is an "actual Case I" company for the accounting period ending with the transfer, then the taxable amount brought into account is the entire "previously untaxed amount" (defined in section 444AB(5) - see below). A company is "actual Case I" if it is a pure reinsurer within section 440B ICTA, or if the company has assessed itself on the basis that the I minus E basis does not apply to it, whether as a result of a determination under paragraph 84(5) Schedule 18 FA 1998 or otherwise. The Inland Revenue will not make a determination under paragraph 84(5) simply to ensure that the whole amount under this section is brought into account, if it would not otherwise do so.

141 Section 444AB(4) gives the amount in the more usual case where a company is subject to the I minus E basis of taxation. In such a case, it is only the profits of its pension, ISA, life reinsurance or overseas life assurance businesses which are charged to tax using a Case I computation, so the part of the section 444AB(2) taxable amount, the previously untaxed amount, is the "non-BLAGAB fraction". The meaning of non-BLAGAB fraction is given by section 444AB(8) and means the fraction:-

$$\frac{\text{liabilities transferred other than BLAGAB}}{\text{liabilities transferred}}$$

142 Section 444AB(5) defines the previously untaxed amount. The starting point in subsection (5)(a) is the fair value of the former L-TIF assets that were not transferred. "Fair value" here, as in section 83(2C) FA 1989 (see paragraph 109 above), has the normal accountancy meaning such as that given in Chapter 2 Part 4 FA 1996 (loan relationships) and Schedule 26 FA 2002 (derivative contracts) – section 444AB(6).

143 However the starting point figure is reduced to the extent if it can be shown that the retained amounts must have come from undistributed surplus. This is done by limiting the amount previously untaxed to the excess of two figures – section 444AB(5)(b).

144 The first is the fair value of the company's L-TIF assets (broadly their Form 13 value, but without regard to admissibility restrictions) immediately before the transfer. The second is the L-TIF liabilities immediately before the transfer. This gives, again in broad terms, the figure which would have been shown in Form 14 line 51 (excess of solvency value over book value) if a periodical return had been drawn up for a period immediately before the transfer. This figure is then assumed to take up the first slice of the retained assets, and sets the limit of the charge.

145 Section 444AB(7) defines the L-TIF liabilities immediately before the transfer. It is the liabilities which would appear in a Form 14 of the periodical return drawn up for a period ending with the transfer, in lines 14 and 49 in column 1 (long-term business fund carried forward and total other and non-insurance liabilities respectively).

146 Example

A company transfers its business. Immediately before the transfer its assets were valued in Form 13 (or would have been so valued if one had been drawn up to the date of the transfer) at £100 million, and for the sake of simplicity it is

assumed that this is their fair value. The entry at line 51 of Form 14 would have been £25 million.

The fair value of the assets left behind is £10 million.

As the £10 million (the section 444AB(5)(a) figure) is less than the £25 million section 444AB(5)(b) figure, the previously untaxed amount, is £10 million.

If the assets left behind has been valued at £30 million, the previously untaxed amount would be £25 million.

The use of "fair value" rather than simply "value" here (which by virtue of section 431(2) means the Form 13 value) is to prevent a company converting its to-be-retained assets into inadmissible assets, such as gold, immediately before the transfer.

147 Paragraph 8(2) gives the commencement date. It applies to transfer schemes taking place in a period of account (including a deemed one by virtue of section 444AA) of the transferor beginning on or after 1 January 2003.

Paragraph 9: modifications of section 83 FA 1989

148 This paragraph gives effect to the third and fourth bullet points in paragraph 12 of the 23 December Note.

Background

149 Where there is a transfer of life assurance business, the transferee assumes the liabilities to policy holders previously owed by the transferor. These liabilities are transferred by operation of law by a Court Order under Part 7 FSMA. Usually the consideration for the transfer of liabilities is the transfer of an amount of assets by the transferor. In the transferee's revenue account on Form 40 drawn up for the period first ending after the transfer, there will often be an entry in line 15 (other income) of Form 40. The description of this item in the note coded 4002 required by instruction 2 of Form 40 (and see paragraph 14.1(10)(b) of Appendix 9.2 IPRU(INS)) will usually refer to it as the fund brought forward from the transferor. Where the amount so described is equal to the liabilities assumed, then inclusion of the amount in section 83(2) as a trading receipt gives the right answer as it ensures that the taxable profit for the period is equal to the surplus for the period as shown on Form 58 line 35 (subject to any other adjustments required by tax law). Exclusion of the fund brought forward figure would result in a wholly artificial loss unrelated to the figure of surplus.

150 However, where the value of the assets transferred to the transferor exceeds the liabilities assumed, then it is likely that the excess represents surplus of the transferor that has already been subject to tax. Accordingly such amounts are not to be taken into account again by the transferee.

151 But it may also happen that the assets transferred and appearing in line 15 of Form 40 are less than the liabilities assumed. Where this happens, a "hole" is likely to appear in the transferee's revenue account unless filled from some other source such as an addition to the fund shown on Form 58 line 34. It may then be claimed that the addition is not a trading receipt and so there will be a loss for tax purposes. In order to

prevent this manoeuvre, any excess of liabilities assumed over assets assumed will be treated as trading receipt.

152 Paragraph 9(1) inserts a new section 444AC into ICTA

153 Section 444AC(1) gives the case. Again, the section applies where there is a Part 7 transfer.

154 Section 444AC(2) deals with the case described in paragraph 149 and 150. It looks to see if there is an excess of one amount over another. The first is the elements of the transferee's line 15 figure representing the transferor's long-term insurance fund (defined by section 444AC(4)). The second is the amount of liabilities assumed from that transferor. Any excess is excluded from section 83(2)(d) FA 1989 – see also section 83(2B)(b) FA 1989.

155 Section 444AC(3) deals with the converse case described in paragraph 151. It looks to see if there is an excess of one amount over another. The first is the amount of liabilities assumed from the transferor. The second is the elements of the transferee's line 15 figure representing the transferor's long-term insurance fund. Any excess is treated as a trading receipt within section 83(2) for the transferee's first period of account ending after the transfer.

156 Section 444AC(4) defines the term "the elements of the transferee's line 15 figure representing the transferor's long-term insurance fund". It is simply the amount in line 15 that represents the transferor's fund carried forward in the period of account ending with the transfer.

Background

157 It may happen that where there is a transfer of business, the transfer of assets will trigger section 83(2B) FA 1989 (see paragraph 108 above). This will apply if the assets represents amounts which have not been reflected in the revenue account of the transferor – they will usually be amounts that would have been reflected in Form 14 line 51 of any periodical return of the transfer drawn up for a period immediately before the transfer. Where those assets come to be held by the transferee as assets of its L-TIF, but in circumstances such that the value of the assets is not brought into account in the revenue account of the transferee, or treated as a transfer to the L-TIF so as to be recognised on Form 58 line 34, then there is a risk of double taxation, as the bringing into account of amounts on line 13 of Form 40 may have the effect of taking the same amount of value of the assets as has been taken into account by virtue of section 83(2B) into account again. Section 444AD aims to prevent this double taxation.

158 Section 444AD also prevents double taxation where section 83(2B) has applied, and the amounts involved are represented in a contingent loan or advance to a transferee. Repayments of the loan or advance will also be brought into charge on the transferee by virtue of section 83(2B).

Detail

159 Paragraph 9(1) also inserts section 444AD into ICTA.

160 Section 444AD(1) gives the case. Again, the section applies where there is a Part 7 transfer.

161 Section 444AD(2) gives the operative rule. If both parties elect, then section 83(2B) FA 1989 is disapplied to the amount specified in subsection (4).

162 Section 444AD(4) gives that amount. It is the excess of two figures. The first is the fair value of the L-TIF of the transferee immediately after the transfer. "Fair value" is defined in section 444AD(5) and has the normal accountancy meaning such as that given in Chapter 2 Part 4 FA 1996 (loan relationships) and Schedule 26 FA 2002 (derivative contracts). The second is the amount brought into account (i.e. reflected in the revenue account) of the transferee in respect of the transfer for the first period of account ending after the transfer. It is irrelevant that any part of the amount brought into account is excluded from tax by section 444AC(2) or is brought into account as an addition to the fund and reflected in a negative amount in Form 14 line 26 or in Form 58 line 34. The relevant amount will be limited to what would have been shown in Form 14 line 51 column of the transferor if a Form 14 had been drawn up as at a date immediately after the transfer.

163 Section 444AD(3) gives the details of the election under subsection (2). It is irrevocable, and must be made within 28 days of the transfer (or by 30 September 2003 if later – paragraph 9(4)). A further condition, similar to those for joint elections in section 200 Capital Allowances Act 2001, is that a copy of the election notice must accompany the transferee's first tax return after the transfer. The normal rules in the CTSA legislation about claims and elections do not apply to this election.

164 Section 444AD(6) gives the relief mentioned in paragraph 158 above. It disapplies section 83(2B) FA 1989 if four conditions are met:-

- That the relevant payments are made to discharge liabilities – paragraph (a)

- That those liabilities arise in respect of an amount lent or advanced to the company so as to become assets of the company's L-TIF, where the amount is derived directly or indirectly from assets of the transferee – paragraph (b).

  ("Indirectly" covers cases where, for example, assets of the transferor become assets of the transferee but not in its L-TIF and are then transferred to the L-TIF, or they become assets of another company before becoming represented in assets of the L-TIF, or both)

- That the assets were not transferred by the transferor directly to the transferee's L-TIF – paragraph (c)

- That the transferor was subject to section 83(2B) FA 1989 in respect of the transfer – paragraph (d)

165 Paragraph 9(2) inserts a definition of "brought into account" into section 431(2).

166 Paragraph 9(3) gives the commencement rule. Both sections apply for periods of account beginning on or after 1 January 2003.

Paragraph 10: Transfers of business: unused losses

167 This paragraph gives effect to the third bullet point in paragraph 18 of the 23 December Note.

Background

168 Section 211 TCGA modifies section 139 of that Act, and allows a no gain/no loss transfers of assets where they are transferred as part of a Part 7 transfer. But if the transferor has allowable losses within the meaning of that Act which it cannot use due to an insufficiency of gains accruing before the transfer, the losses may be stranded. It may under existing law be possible to generate gains to mop up the losses before transfer by a "bed and breakfast" type transaction, but that may be costly, and may not be possible following the modification of section 106 made by paragraph 3 of the Schedule (see paragraph 29 above). Following representations made by the industry the Government has decided to allow allowable losses to be carried over in the exceptional case of a Part 7 transfer.

169 There is an existing Extra-Statutory Concession C29 which permits a carryover of a restricted category of allowable loss. These losses are ones which were transformed from being general annuity business ("GAB") Case VI losses into allowable losses by paragraph 17 Schedule 7 FA 1991, when GAB was abolished as a separate category of business. The new legislation will subsume these losses and the ESC will cease to apply.

Detail

170 Paragraph 10(1) inserts new sections 211ZA, 211ZB and 211ZC into TCGA.

171 Section 211ZA is the main rule allowing the carry over.

172 Section 211ZA(1) gives the case. It applies where there is a Part 7 transfer and the transferor has "relevant unused losses". Section 211ZA(2) defines that term. There are relevant unused losses if allowable losses accrued to the transferor in the accounting ending with the transfer or any earlier accounting period of it while it was chargeable to corporation tax, and the losses are not deducted from gains accruing in any of those periods.

173 Section 211ZA(3) sets out the operative rule where the whole of the transferor's BLAGAB is transferred. The relevant unused losses cease to be available to the transferor and become available to the transferee as if they had accrued to the transferee. If there is more than one transferee of the transferor's BLAGAB, section 211ZA(7)(a) requires the relevant proportion of the relevant unused losses to be transferred to each transferee, and that proportion is the one which is represented by the fraction:

$$\frac{\text{market value just before the transfer of BLAGAB chargeable assets going to transferee}}{\text{market value at the same time of all the transferor's BLAGAB chargeable assets}}$$

174 Market value ("MV") has its TCGA meaning (section 272); "chargeable assets" means assets on which a chargeable gain would accrue, ignoring gains accruing by

virtue only of section 116(10) TCGA (qualifying corporate bonds carrying a frozen gain) - section 211ZC(3).

175 Section 211ZA(4) applies if only part of the transferor's BLAGAB is transferred (and follows the fourth paragraph of ESC C29). In such a case the transferor and transferee can elect to specify an amount of relevant unused losses which accrue to the transferee. The amount specified cannot exceed the appropriate fraction of the relevant unused losses – section 211ZA(5) – and that fraction is – section 211ZA(6):-

$$\frac{\text{MV just before the transfer of BLAGAB chargeable assets going to transferee}}{\text{MV at the same time of all the transferor's BLAGAB chargeable assets}}$$

176 Section 211ZA(7)(b) applies if the transfer of part of the transferor's BLAGAB is to two or more transferees. In such a case section 211ZA(5) and (6) apply separately to each transferee.

177 Section 211ZB provides the streaming rules for the transferee, based on those in the fifth paragraph of ESC C29.

178 Section 211ZB(1) gives the main rule. Relevant unused losses are available to be deducted from chargeable gains of the transferee, but not gains accruing before the transfer – section 211ZB(6).

179 If the transferee's only long-term business is the business transferred (so that the transferor starts to carry on business as a result of the transfer) the losses may be deducted from all L-TIF gains – section 211ZB(2)

180 If the business transferred is included in a separate fund or sub-fund of the transferee which only contains the transferred business, the losses may be deducted from all L-TIF gains accruing on assets in that fund – section 211ZB(3)

181 In any other case the losses may be deducted from the relevant fraction of the transferee's L-TIF gains – section 211ZB(4) – and that fraction is – section 211ZB(5):-

$$\frac{\text{MV just before the transfer of the chargeable assets going to transferee}}{\text{MV at the end of transferee's first post-transfer AP of its chargeable L-TIF assets}}$$

182 Section 211ZC contains supplementary material.

183 Section 211ZC(1), (3) and (4) contains interpretative material for sections 211ZA and 211ZB (and the section itself).

184 Section 211ZC(2) gives the details of the election under subsection (2). They are the same as those in section 444AD(3). The election is irrevocable, and must be made within 28 days of the transfer (or by 30 September 2003 if later – paragraph 10(3)). A further condition, similar to those for joint elections in section 200 Capital Allowances Act 2001, is that a copy of the election notice must accompany the transferee's first tax return after the transfer. The normal rules in the CTSA legislation about claims and elections do not apply to this election.

185 Paragraph 10(2) gives the commencement rule. It has effect in relation to Part 7 transfers taking place on or after 1 January 2003 (irrespective of when the accounting periods began). This is because, despite being retrospective, is it is a relieving section.

Paragraph 11: adjustments of opening and closing liabilities

186 This paragraph gives effect to the second bullet point in paragraph 18 of the 23 December Note.

Background

187 In a number of provisions relating to the taxation of life assurance companies, apportionments are made by reference to the mean of the opening and closing liabilities of a period of account. And in some cases opening and closing asset values are used, and in section 432A(6) ICTA the opening an closing amounts of the "investment reserve".

188 "Liabilities" and "value" have meanings taken from the periodical return (the FSA return) made and deposited under Rule 9.3 IPRU(INS) – section 431(2). "Investment reserve" is defined in section 432A(9B) ICTA. "Opening" and "closing" are also defined in section 431(2) to mean the figures at the beginning and end of a period of account. They do not mean at the beginning and end of an accounting period, if different. Where an accounting period is not coincident with a period of account (as for example where a Part 7 transfer takes place before the end of a period of account) the opening and closing figures in relation to the accounting period are the figures for the period of account in which the accounting period falls.

189 Problems arise where there is a Part 7 transfer part way through a period of account. Take this example:-

A period of account starts on 1 January when the company has

BLAGAB liabilities	1000
Pension liabilities	1000

On 30 September it transfers pension liabilities of 500 in a Part 7 transfer

On 31 December it has

BLAGAB liabilities	1000
Pension liabilities	500

Assume that the company earns a 10% return on its assets (whose amount is equal to its liabilities) evenly throughout the year. It would be expected that it would have income of 100 on its BLAGAB assets, and 87.5 on its pension assets (1000 @ 10% for 9 months; 500 @ 10% for 3 months)

Section 432A requires the mean of the opening and closing liabilities of each category as a fraction of the total to be applied to the total income.

BLAGAB mean is (1000 + 1000)/2 = 1000
Pension mean is (1000 + 500)/2 = 750

Total mean is (2000 + 1500)/2 = 1750

Thus BLAGAB income is 1000/1750 x 187.5 = 107
Pension income is 750/1750 x 187.5 = 80.5

QNED

190 Similar distortions arise where the transferee acquires liabilities and assets in a Part 7 transfer part way through a period of account. Paragraph 11 is intended to remove these distortions.

Detail

191 Paragraph 11(1) paves the way for amendments to section 431 ICTA.

192 Paragraph 11(2) restores the definition of “investment reserve” to section 431 from section 432A(9B), as it will now be used in more than one section of the Act. There may be further consequential amendments required as a result of this move.

193 Paragraph 11(3) makes the main amendments by inserting subsections (2ZA) to (2ZD) into section 431.

194 Section 431(2ZA) gives the case. It is where there is a Part 7 transfer.

195 Section 431(2ZB) applies where for a transferor, a transfer takes place otherwise than on the last day of a period of account. This will be the case where a part transfer takes place during the period of account, or where a whole transfer takes place and a periodical return is made for a period ending after the transfer.

196 In this case a fraction (A/C) is applied to the opening liabilities, opening values of assets and opening amount of the investment reserve, so far as they relate to the transferred business.

197 Section 431(2ZC) applies where for a transferee, a transfer takes place otherwise than on the first day of a period of account. In this case a fraction (B/C) is applied to the closing liabilities, closing values of assets and closing amount of the investment reserve, so far as they relate to the transferred business.

198 Section 431(2ZD) gives the definitions of A, B & C.

- A is the number of days from the beginning of the period of account to the transfer
- B is the number of days from the transfer to the end the period of account
- C is **half** the number of days in the period of account.

199 Apply this to the example above:-

A period of account starts on 1 January 2003 when the company has

BLAGAB liabilities	1000
Pension liabilities	1000

On 30 September it transfers pension liabilities of 500 in a Part 7 transfer

On 31 December it has

BLAGAB liabilities	1000
Pension liabilities	500

Assume that the company earns a 10% return on its assets (whose amount is equal to its liabilities) evenly throughout the year. It would be expected that it would have income of 100 on its BLAGAB assets, and 87.5 on its pension assets (1000 @ 10% for 9 months; 500 @ 10% for 3 months)

Section 432A(2ZB) requires an adjustment to the opening figures for the transferred business.

A is 273
C is 182.5

So

opening BLAGAB liabilities are 1000 (as none transferred)
opening pension liabilities 500 (not transferred) plus
500 x 273/182.5 = 748 (total 1248)

the mean of the opening and closing liabilities of each category as a fraction of the total is then applied to the total income.

BLAGAB mean is (1000 + 1000)/2 = 1000
Pension mean is (1248 + 500)/2 = 874

Total mean is (2248 + 1500)/2 = 1874

Thus BLAGAB income is 1000/1874 x 187.5 = 100
Pension income is 874/1874 x 187.5 = 87.5

QED

200 Paragraph 11(4) gives the commencement. It applies to Part 7 transfer schemes taking place on or after 1 January 2003 unless the accounting period of the transferor ending with the transfer began before that date.

Paragraph 12: reinsurance of BLAGAB risks

201 This paragraph gives effect to a point not mentioned in the 23 December Note, but which has been brought to the attention of industry bodies.

Background

202 Section 442A ICTA was enacted in Finance Act 1995 as part of the reform of reinsurance business. It was designed to stop avoidance of tax on the investment return accruing for policy holders and shareholders under the I minus E basis. By reinsuring the investment risk in a life assurance policy the company was replacing the investment return it could otherwise earn on the amount of its premiums paid to the reinsurer with a reinsurance recovery when the policy matured that was arguably outside the I minus E charge, depending on the view taken of the effect of section 547(2) ICTA.

203 Section 442A provided for the imputation of an investment return on the reinsurance premium. The detailed rules are in regulations 3 to 10 of the Insurance

Companies (Reinsurance) Regulations 1995 (SI 1995/1730). The question that arose was whether section 442A works properly when a reinsurance contract is transferred in a Part 7 transfer.

204 The effect of the transfer on section 442A appears to be this. If the arrangement was within section 442A when it was made by the transferor, income will have been imputed period by period over the life of the arrangement. An imputation will be made for the period ending with the transfer, but there will be no final reckoning under regulations made by virtue of s 442A(4) because that is not the final period during which the policy or contract (which means here the underlying policy) is in force.

205 The transferee is a company which is reinsuring a risk in respect of a policy - section 442A(1) - so by virtue of that subsection an investment return is to be attributed to it, but “over the period of the reinsurance arrangement.” Is that to be taken to mean the period of the reinsurance arrangement so far as it is an arrangement between the transferee and the reinsurer? That would give a sensible answer with the result that an investment return may be attributed to the transferee over the period it is a party to the arrangement.

206 But when it comes to the calculation of the investment return under section 442A(3) and the regulations, the calculation should take into account payments made by the transferor as well as the transferee, but the singular reference to “the company” suggests that only payments made by the transferee may be taken into account. Similarly with payments made to the “company” in section 442A(3)(b) and the return accruing to “the company” in section 442A(3)(c).

207 However section 442A(4) seems fine as it stands – the amount of the final adjustment should be calculated by comparing the profit over the whole period with the imputed amounts over that period, irrespective of who was party to the arrangement.

208 Paragraph 12 is designed to clear up these issues.

Detail

209 Paragraph 12(1) paves the way for amendments to section 442A.

210 Paragraph 12(2) amends section 442A(1) to make it clear that the imputation to any company, transferor or transferee, is only operative for the period during which it is the cedant.

211 Paragraph 12(3) inserts a new section 442A(3A). This provides that where there is a transfer of a reinsurance arrangement either by novation or in a Part 7 transfer (and the High Court has recently confirmed that a reinsurance contract may be transferred as part of a Part 7 transfer – *Re WASA International Insurance Co* [2002] EWHC 2698 (Ch)) then references to “the company” in subsection (3) are to the transferee, the transferor and any earlier transferor.

212 Paragraph 12(4) amends section 442A(4) by omitting the words “to the company” so that the final period adjustment is calculated by reference to all earlier imputed amounts.

213 It may be that amendments are required to SI 1995/1730.

214 Paragraph 12(5) gives the commencement rule. It applies to transfers of reinsurance arrangements taking place on or after 1 January 2003.

Paragraph 13: carry over of Case VI losses

215 This paragraph gives effect to the fifth bullet point in paragraph 18 of the 23 December Note.

Background

216 Under section 444(3A) ICTA there is an unrestricted carry forward of Case VI losses relating to pension & ISA business and life reinsurance business, and of certain overseas life assurance business losses. It has always been anomalous that these losses, which are entirely matters to do with the shareholders' interest in the life assurance business, can be carried over like the other matters which are predominately policy holder matters – as the rationale for the tax neutrality of Part 7 transfers is that it is the policy holder interest in the business remains unchanged.

217 However there are circumstances where trading losses can be carried over generally, and not just in life assurance business, where a trade is transferred from one company to another – in section 343 ICTA. This section applies to any Case I losses of a life assurance company on the occasion of a Part 7 transfer where the conditions in the section are met (mainly that there is a 75% commonality of shareholder interest both before and after the transfer).

218 Accordingly the ability of a company to carry over a Case VI loss from any of the categories of life assurance business is to be subject to the same conditions as apply to Case I losses.

Detail

219 Paragraph 12(1) paves the way for amendments to section 444A ICTA.

220 Paragraph 12(2) amends section 444A(3) (which relates to the carry over of Case VI losses) by making it a condition of its operation that the conditions of section 343(1)(a) and (b) are satisfied. Those conditions are that at any time in the two years after the transfer of a business a 75% interest in the trade is held by the same persons as had such an interest in the period of a year before the transfer and that the trade is not carried on in that period by a company not within the charge to CT.

221 Paragraph 12(3) inserts a new section 444A(3ZA). This provides that in any case where a loss is available to carry over in accordance with the revised section 444A(3A) the other provisions of section 343 and 344 apply. The main effect of applying those provisions is that:-

- there is a stand in shoes carry over of capital allowances – section 343(2)

- carry over is restricted where the amount of "relevant liabilities" exceeds the market value of "relevant assets" – section 343(4) and 344(5) to (12).

- “relevant assets means assets of the transferor not transferred plus any consideration given to the transferor other than the assumption of liabilities. Thus in a Part 7 transfer, it is likely that “relevant assets” will simply mean the assets retained.

- “relevant liabilities” are liabilities outstanding not transferred to the transferee.

- securities (which for this purpose is restricted to shares) transferred are treated for the purposes of section 731 as sold and repurchased – section 343(5)

- where there is a subsequent transfer by the transferee, the two or more transfers are looked at together – section 343(7)

- there is streaming where only part of the business concerned is transferred, or where the business or part business transferred does not constitute the whole such business of the transferee – section 343(8). A just and reasonable apportionment is made in such cases – section 343(9). **Revenue Guidance will suggest ways in which this apportionment might be done. Readers are invited to suggest what that Guidance might say**.

222 Paragraph 11(4) gives the commencement rule. It applies to a Part 7 transfer taking place on or after 1 January 2003, unless the accounting period of the transferor ending with the transfer began before that date, or the transferee’s accounting period which includes the transfer began before that date.

PARTICULAR POINTS ON WHICH READERS ARE ASKED TO GIVE THEIR VIEWS

1. Readers are invited to suggest any ways that occur to them of finding a way of allowing only the shareholders' share of losses to be deducted from non L-TIF gains that is both fair to the Exchequer and does not involve complicated tracking rules and compliance costs. (Paragraph 22)

2. Readers are asked to say whether reintroducing life assurance companies to section 106 would give rise to major difficulties, particularly in compliance. They are asked to suggest, if they think it appropriate, alternative methods of discouraging bed and breakfast which would be simpler to operate but which would as effective. (Paragraph 35)

3, Readers are asked to consider whether there should be a rule which permits the loss released to be available to a transferee under a Part 7 transfer, particularly where the original company has ceased to carry on business as a result of the transfer. (Paragraph 46)

4. Readers are invited to suggest whether there are any exclusions from this rule that could be made without recreating the mischief against which it is aimed, and if so, how. For example, could transfers made to comply with the requirement of paragraph 3(1) Schedule 19AA (replenishment of the overseas life assurance fund) be safely excepted? Could transfers of section 212 assets? (Paragraph 50)

5. Although section 82(1)(b) and related provisions are effectively repealed by the current draft, the need for transitional measures will have to be considered along with any representations that some measure of relief should be retained for companies that have previously claimed relief. Readers are asked to give their views on what might be appropriate here. (Paragraph 83)

6. Readers are invited to suggest what approach(es) the regulations should take. It is hoped to have adrift of any regulations available by the time the Finance Bill is published. (Paragraph 92)

7. Readers are asked to say whether any, and, if so, what further amendments to either section 83 FA 1989 or Chapter 2 Part 4 FA 1996 are necessary to achieve the desired outcome. (Paragraph 107)

8. The Inland Revenue recognises that there is a case for treating repayments of contingent loans and advances differently according to the accounting treatment of the principal received when the loan was made. The Inland Revenue will be pleased to discuss the most appropriate basis for distinguishing different treatments of such loans, and readers are invited to make representations on this point accordingly. (Paragraph 111)

9. Revenue Guidance will suggest ways in which this apportionment might be done. Readers are invited to suggest what that Guidance might say. (Paragraph 221)