

PRE-BUDGET REPORT

2 December 2004

INSURANCE COMPANIES

DRAFT TAX LEGISLATION & COMMENTARY

PRE-BUDGET REPORT

INSURANCE COMPANIES DRAFT LEGISLATION

These notes explain the draft legislation, published today on the Inland Revenue's website, consisting of a clause and schedule for the Finance Bill and an Order to be made under section 431A of the Income and Corporation Taxes Act 1988 (ICTA).

The draft legislation gives effect to the announcement made in the Pre-Budget Report that legislation would be introduced to close loopholes in the current life assurance tax legislation, and to make other amendments as a result of reforms being introduced by the Financial Services Authority (FSA) to its Prudential Handbook.

Comments on the draft Order should be sent to Richard Thomas & Robert Peel, Revenue Policy (Business Tax), Room 5W1 22 Kingsway, London WC2N 6NR before 8th December or by e-mail to richard.thomas@ir.gsi.gov.uk and robert.peel@ir.gsi.gov.uk.

Comments of the draft clause and Schedule should be sent to Richard Thomas & Robert Peel, Revenue Policy (Business Tax), 3rd Floor, 1 Parliament Street, London SW1A 2BQ (after 15th December) or by e-mail to richard.thomas@ir.gsi.gov.uk and robert.peel@ir.gsi.gov.uk.

Clause 1

1 Clause 1 (not included in the published drafts) is merely introductory and provides for the schedule to have effect.

The Schedule

2 Both the Schedule and the Order introduce the amendments to various provisions in the order in which they appear in the Tax Acts. For the purposes of this note the paragraphs and articles are considered by theme.

3 In the Schedule, as well as in these Notes, we have used the abbreviations ICTA for the Income and Corporation Taxes Act 1988 and FA 1989 for the Finance Act 1989. The intention is that these acronyms are to be defined in an interpretation clause in the Finance Bill.

Regulatory Reform – 2004 changes

Section 76 Income & Corporation Taxes Act 1988 (ICTA)

4 Paragraph 1 provides an amendment to section 76 ICTA (expenses of companies carrying on life assurance business).

5 Section 76(8) of that Act provides that an attribution of expenses of a life assurance company to basic life assurance and general annuity business (BLAGAB) has to be made under what the statute calls “proper internal accounting practice”. The subsection provides that in deciding what is such practice, regard must be had both to generally accepted accounting practice and to the Interim Prudential Sourcebook (Insurers) – IPRU(INS), which is the sourcebook currently applying to insurers.

6 However, the Financial Services Authority (FSA) has made an instrument¹ enacting parts of its Integrated Prudential Sourcebook (PRU) applying to insurers. This has effect on 31 December 2004 and therefore applies to a company's periodical return to the FSA ending on that date.

7 Accordingly, paragraph 1(2) inserts a reference to the Integrated Prudential Sourcebook in section 76(8).

Sections 431 and 432A ICTA

8 Paragraph 2 amends section 431(2) ICTA. That subsection is an interpretation provision for all legislation applying to insurance companies including Part 1 of Chapter 12 ICTA, sections 82 to 90 Finance Act 1989 and certain provisions of the Taxation of Chargeable Gains Act 1992.

9 Paragraph 2(2) inserts a definition of the Integrated Prudential Sourcebook.

10 Paragraph 2(3) changes the definition of “liabilities”. The Prudential Sourcebook includes new rules that must be followed by companies writing a substantial amount of with-profits business in calculating their capital requirements. They must calculate the value of their assets and liabilities (and so the margin of difference) not only in accordance with the existing regulatory rules based on the EC Consolidated Life Insurance Directive² but also using what is known as “realistic” reserving. The company's capital requirement is based on the higher of the two figures (the so called “twin peaks” approach).

¹ Integrated Prudential Sourcebook (Insurers and Other Amendments) Instrument 2004 (FSA 2004/87)

² 2002/83/EC

11 The calculation of liabilities relating to insurance business, under the realistic approach, is very different from the calculation under the existing “regulatory” approach. And the calculation of the regulatory liabilities for those companies also differs somewhat from the existing basis, which will continue to be used by non-twin peaks companies.

12 Not all companies will use the twin peaks approach. So it was necessary to decide whether to

- follow the realistic figure of liabilities for those companies required to use it
- allow an option to use either the realistic or regulatory approach for those companies or
- require use of the regulatory approach for all companies.

13 Since the regulatory liabilities will be the ones used in all cases for determining surplus and in the interests of having a consistent approach as far possible to all companies, the Government has decided that the regulatory liabilities will continue to be the ones which are used for tax purposes. It is aware, however, that the calculation of the realistic liabilities for those companies using the twin peaks approach differs somewhat from the existing calculations which will continue to be used by companies not using the twin peaks approach. But it is not thought to be appropriate to require either class of company to use a basis for calculating its liabilities which is not the basis it uses in its periodical return.

14 Accordingly, paragraph 2(3) now defines liabilities to mean the mathematical reserves of the company determined in accordance with Chapter 7.3 of PRU. “Mathematical reserves” is the term continuing to be used in PRU for the regulatory calculation of liabilities.

15 The new definition of “liabilities” also includes deposit- back arrangements where the value falls to be determined in accordance with Chapter 1.3 of PRU.

16 In the existing definition of “liabilities” there is a mention of “long-term liabilities” which is then separately defined. There is now no need for a separate definition of “long-term liabilities” as by referring to “mathematical reserves” it follows automatically that the liabilities concerned are long-term liabilities. Thus paragraph 2(4) omits the definition of “long-term liabilities”.

17 The Inland Revenue is also aware that in the calculations of realistic liabilities for 2004 what had previously been shown as resilience reserves as part of the mathematical reserves are no longer included in them, but are shown as part of the capital. Where a company makes a book value election under what has been Rule 4.1(6) in IPRU(INS), it is likely that any decrease in liabilities (and thus potential increase in surplus) can be managed through the book value difference recognised in line 13 of Form 40. But the Inland Revenue would like to know if there are particular difficulties for non-profit funds and what the scale of the unavoidable increases in surplus will be for those funds.

18 Paragraph 4 as a consequence of that omission changes the reference to “long-term liabilities” to “liabilities” in section 432A(9A) ICTA which relates to the exclusion of the overseas life assurance fund in certain calculations of apportionment of income and gains.

19 Paragraph 2(5) makes a corresponding change to the definition of “value”. The valuation of asset rules in the IPRU(INS) are moved to PRU and so the reference now is to Chapter 1.3 of PRU.

Section 444BA ICTA

20 Paragraph 7 makes another consequential amendment, this time to section 444BA ICTA which relates to equalisation reserves for general insurance business.

That legislation depends substantially on figures in the equalisation reserves of a company calculated in accordance with “Equalisation Reserves Rules”, currently in Chapter 6 of IPRU(INS). Paragraph 7(2) changes the reference to Chapter 6 to become one to Chapter 7.5 of PRU where the new Equalisation Reserve Rules are to be found. An equivalent change to regulation 2 of the Insurance Companies (Reserves) (Tax) Regulations 1996³ is being made by a separate Statutory Instrument.

Section 82B Finance Act 1989

21 Paragraph 9 amends section 82B Finance Act (FA) 1989. That section deals with those few companies which write with-profits business but which do not elect under the current Rule 4.1(6) IPRU(INS) to attribute a value to their assets which is lower than market value in order to create a “reserve” to meet in particular future terminal bonus payments. Instead such companies keep an amount in their unappropriated surplus to meet those eventualities.

22 One of the conditions of the operation of section 82B is that the company does not make the book value election in accordance with Rule 4.1(6). Chapter 4 IPRU(INS) is being deleted as a result of the inclusion in PRU of the Asset Valuation Rules previously in Chapter 4. But Rule 4.1(6) is not being reproduced in PRU but is moving to Chapter 9 of IPRU(INS), the Accounts and Statements Rules, where it becomes rule 9.10(c). Paragraph 9(2) makes the change.

23 Paragraph 3 amends the regulatory making power in section 431A ICTA. Because a number of the changes currently being made have effect for periods of account ending on 31 December 2004 and so will primarily affect periodical returns covering the 2004 calendar year, it has not been possible to use section 431A to make the amendments.

24 In order to make section 431A more effective for the future, paragraph 3(3) inserts a new subsection (2) into section 431A, paragraph 3(2) having renumbered the entire section as sub-section (1).

25 The new subsection (2) allows amendments to be made to the tax provisions relating to insurance companies having effect for a period which is the period for which the relevant FSA changes also have effect.

Commencement

26 All the changes except those to section 431A described above have effect in relation to periods of account ending on or after 31 December 2004. The changes to section 431A will have effect from Royal Assent as until then regulations cannot be made using the extended power

Regulatory Reform – 2005 changes

27 The Financial Services Authority is also making amendments to the periodical return to have effect for the return for periods beginning on 1 January 2005. Because these changes are prospective it is possible and expedient to use the regulatory power in section 431A ICTA to make these changes. The order is the Insurance Companies (Corporation Tax Acts) Amendment Order 2004

28 Article 6 of the draft Order amends subsections (2) and (3) of section 444AC which deals with transfers of business. That section defines a certain excess of assets over liabilities in a transfer by reference to what the section calls the “line 15 figure”. Section 444AC(3) defines that term as part of a larger term “the element of the transferee’s line 15 figure representing the transferors long-term insurance fund”

³ SI 1996/2991 as amended by SI 2001/3629

as being the amount by which “the amount which is brought into account by the transferee as other income” exceeds assets.

29 Line 15 is a reference to line 15 in form 40 (the Revenue account) in a periodical return. That line shows “other income”.

30 The current FSA return requires a company which accepts a transfer of business to include the amount representing the long-term insurance fund of the transferor as other income in line 15. In future, however, transfers in of business will be shown in a new line 31 of Form 40 and so article 4 makes the necessary change to refer to “line 31”.

31 This change will also have effect in relation to the reference to the “line 15 figure” in the new section 444AC(2A) introduced by paragraph 6(3) of the Schedule (see paragraph 36 below).

32 In addition the references in section 444AC to “other income” are changed to refer to “business transfers-in”.

33 Article 7 makes the same change to “line 15” in section 444AD(4)(b) which also refers to the line 15 figure.

Transfers of Business

34 Schedule 33 Finance Act 2003 and Schedule 7 Finance Act 2004 made a number of changes to the tax treatment of transfers of insurance business primarily to close loopholes and to block attempts to exclude profits from tax or to prevent profits which would emerge in normal course of events after the transfer from ever emerging at all. Despite these measures companies have continued to look for ways to achieve this result without falling foul of the existing law. The changes made by paragraphs 5, 6 and 10 of the Schedule will stop three more ways that have been found to exploit the rules.

Transfers with excess liabilities

35 Paragraph 6 amends section 444AC of the Taxes Act. That section currently provides a relief from tax in a case where a company transfers more assets than liabilities and where the excess represents surplus that has already been brought into charge to tax in the hands of the transferor. When that section was originally exposed in draft in 2003 it included a further provision which provided that in the opposite case where the liabilities transferred exceeded the assets a charge to tax would arise on the difference. Representations were made at the time that this rule was unnecessary having regard to some of the other changes being made in FA 2003 and that it would not be possible to use this type of transfer to avoid tax. Accordingly, the relevant provision was deleted from the Finance Bill 2003. However, it has become clear that those assurances were over-optimistic. The Inland Revenue has seen transactions where there has been a transfer of excess liabilities designed to exclude profits from tax and which are not caught by any other provisions of the life assurance taxes provisions.

36 Accordingly, the rule omitted from Finance Bill 2003 is being reinstated as section 444AC(2A) and (2B). Section 444AC(2A) sets out the case – where the liabilities to policyholders and annuitants transferred, together with any relevant debts, exceeds the “element of the transferee’s line 31 figure representing the transferor’s long-term insurance fund” i.e. the figure included in line 31 of form 40. Section 444AC(2B)(a) then provides that the excess is to be treated as a trading receipt of the transferee’s life assurance business for Case I purposes for the period of account of the transfer, and section 444AC(2B)(b) that the relevant proportion of the excess is to be treated as a receipt of any category of business. The relevant proportion is the proportion that the category liabilities included in the transfer bear to the total liabilities so included.

37 This provision differs from that originally drafted for the Finance Bill 2003 in that it includes “relevant debts” as well as liabilities to policyholders and annuitants. Paragraph 6(4) inserts a new section 444AC(4) defining relevant debts to mean debts which become debts of the transferee’s long-term insurance fund as a result of the transfer. This therefore includes any transfer of liabilities which are not insurance liabilities such as bank borrowings.

38 Paragraph 6(2) also inserts a reference to relevant debts into section 444AC(2) to bring the calculation there into line with that in section 444AC(2A). Relevant debts are already taken into account in section 444AB where they are included in “the retained liabilities” and in section 82C(5) Finance Act 1989 which also deals with the deficiency of assets where there is a financial reinsurance (but see notes on paragraph 9 of the Schedule below).

39 Paragraph 6(3) also inserts new subsections (2C) and (2D) which deal with exceptions from the charge under subsection (2B). The exception applies where the excess liabilities transferred are disallowed for the purposes of the Corporation Tax Acts in computing the company's Case I profit (subsection (2C)) or its Case VI from any category of business (subsection (2D)), and where the liabilities disallowed are liabilities at the end of the period of transfer, there is a condition that the opening liabilities of the next period are not adjusted.

40 New section 444AC(2E) also inserted by paragraph 6(3) defines “transferred liabilities” in the previous two subsections to mean either liabilities shown at the end of the period of account of the transferee in which the transfer takes place, or amounts actually paid to discharge such liabilities by way of payment of claims.

41 Paragraph 6(4) inserts a new section 444AC(5) which glosses transferred liabilities. In arriving at the figure any financial reinsurance associated with the transferred liabilities is disregarded so that they are not reduced by reinsurance. This is necessary because, among other reasons, the definition of “liabilities” inserted into section 431(2) by paragraph 2 of the Schedule automatically sets off reinsurance.⁴

42 Paragraph 6(4) also inserts a new section 444AC(6) which contains a definition of “insurance business transfer scheme” using the extended definition currently appearing in section 444AA(6) and section 82C(9) Finance Act 1989. The extended definition covers transfers of business which is carried on outside the European Economic Area. The normal definition of “insurance business transfer scheme” given by section 431(2) ICTA only covers transfers falling within Part 7 of the Financial Services and Markets Act 2000 which requires the business transfer to be carried on in an EEA state. Paragraph 6(6) provides the commencement rule for the changes to section 444AC. They apply to where there is an insurance business transfer scheme taking place on or after 2 December 2004 (the date of the PBR).

43 Paragraph 6(5) amends the heading to reflect the new scope of the section. Paragraph 6(7) is an ephemeral rule – it provides that in relation to a transfer between 2 December 2004 and the start of a company’s use of the revised FSA return, “line 31” in section 444AC(2A)(b) is to be read as “line 15”.

44 Article 10 also makes some amendments to cater for the fact that “business transfers-in” are on line 31 of Form 40. It amends section 83(2) FA 1989 so that it has a new paragraph (e) to cover “business transfers-in”, and inserts a reference to the new section 83(2)(e) in section 83(2A). It also amends section 83(2B) to ensure that business transfers-out are covered by the rule that items taken through the

⁴ See Rule 7.3.29(4) and sections 7.3.79 to 7.3.92 PRU

revenue account as total expenditure continues to work when transfers-out are removed from the expenditure lines.

45 Article 11 makes similar amendments about line 15 and business transfers-in in section 83ZA FA 1989 (contingent loans etc).

46 Article 5 takes the opportunity given by the exclusion of business transfers in from Form 15 to take them out of the section 432B to 432F processes to which they are ill suited. It inserts a new section 432G to provide the apportionment rule. It, like the excess liability apportionment rule in section 444AC(2B), apportions the transfers in the proportion that the liabilities transferred referable to a particular category bear to the whole. Article 4 ensures that this rule overrides section 432E(1).

Consequential amendments to section 82C FA 1989.

47 Paragraph 10 amends section 82C which concerns financial reinsurance contracts. Section 82C operates where either of two conditions is met. One of those conditions, condition B, applies where there is a transfer of business with a deficiency of assets. This case is now covered by section 444AC(2A) (see paragraphs 36 to 43 above), so it is no longer necessary to include condition B. Paragraph 10(2) amends section 82C(1) to delete the reference to condition B and paragraph 10(3) omits subsections (4), (5), (8) and (9) which are the subsections dealing with condition B.

48 These amendments have effect where there is an insurance business transfer scheme within the extended meaning, that given by section 82C(9), which takes place on or after 2 December 2004.

49 Where there was a transfer of business before that date to which condition B applied the provisions of section 82C dealing with the recapture of liabilities and the charge to tax arising in subsequent periods will continue to apply.

Case where shares in the transferor are assets of the transferee's long-term insurance fund.

50 Paragraph 7 inserts a new section 444ACA into ICTA.

51 New subsection (1) provides for the case which is where there is an insurance business transfer scheme (within the extended definition given by section 444AC(5)).

52 New subsection (2) is the operative rule. The section operates where the transferor is a company whose shares are assets of the long-term insurance fund of the transferee and where as a result of the transfer, the fair value of those shares is reduced. It will also apply where the shares in the transferor are held indirectly, so that the asset of the fund whose value is reduced by the transfer is shares in an intermediate company – see definition of “relevant shares” in new section 444ACA(3).

53 In an insurance business transfer scheme it is usually the case that the assets of the transferor are transferred to the transferee in consideration only of the transferee assuming the liabilities of the transferor. Thus where the transferor has an excess of assets (including the value of in-force business) over liabilities the result of the transfer, the value of the shares will fall by roughly the amount of the excess.

54 Where the provisions of the Taxation of Chargeable Gains Act (TCGA) 1992 apply to this transaction (i.e. where the assets are such that gains fall within BLAGAB income and gains), such a transfer would be regarded as a depreciatory transaction falling within section 176 TCGA and an adjustment would be made to the amount of any allowable loss arising. This is what will happen so far as any loss on the shares is attributable to the company's BLAGAB. But where the shares

and the transactions in them are referable to other categories of business, and also in computing the profits of the life assurance business in accordance with the rules of Case I of Schedule D, the rules dealing with a reduction in the value of shares for Case I purposes may not cover this case. It is possible that in certain cases the provisions of section 703 to 709 ICTA (see head B of section 704) may apply, as may section 736 ICTA.

55 But section 444ACA will apply in any case where section 703 does not apply and will apply in priority to section 786. What it does is to treat an amount equal to the reduction in fair value of the shares as a receipt of the transferee for the purposes of section 83(2) of the Finance Act 1989 in the period of account in which the transfer takes place. New subsection (4) defines “fair value” by reference to the meaning given in section 444AB(6), which is the amount which would be obtained from an independent person purchasing the assets or, if the assets are money, their amount.

56 This new section also applies in relation to insurance business transfer schemes within the extended definition taking place on or after 2 December 2004.

57 Paragraph 5 makes consequential adjustments to section 432E(2A) ICTA. Because section 444ACA amounts do not feature in any revenue accounts of the company, it is necessary to add them to the section 83(2) net amount to be apportioned under section 432E(2), in the same way as amounts falling within section 83(2B) FA 1989. Paragraph 5(2) and (3) makes the necessary changes, and paragraph 5(4) gives the changes the same commencement rules as section 444ACA.

“Notional” income

58 Paragraph 11 modifies section 83(2A) Finance Act 1989. That subsection includes three exemptions from the rule in section 83(2) that all amounts shown in lines 12 to 15 of Form 40 are automatically to be brought into account as receipts for tax purposes. One of the exceptions is for “notional income”.

59 The Inland Revenue has become aware that some companies may be seeking to argue that amounts brought into account in those lines constitute notional income, even though there is nothing notional about them. The argument is based on the definition of “notional income” in section 83(2A)(a). The Inland Revenue does not accept that the definition is such that amounts which are not notional in any sense can be treated as notional income. But for the avoidance of doubt having regard to the amounts of money that may be involved section 83(2A)(a) is being amended. Paragraph 11(2) provides that the existing paragraph (a) is divided into two. There is a new paragraph (a) referring to notional income as defined in the new section 83(2AA) and a separate exclusion in new paragraph (aa) for inter-fund transfers.

60 Paragraph 11(3) inserts a new section 83(2AA) to define notional income more precisely. Income is only to be regarded as notional income if it represents income which has not in fact been received or is not receivable from another person and where a corresponding notional expense of the same amount is also brought into account. This rule therefore continues to exempt the kind of notional income for which section 83(2A)(a) was designed - such as notional rents on land held by the company. The broad intention is that “notional income” should encompass only amounts created as a result of a book-keeping entry in the regulatory return that creates a corresponding entry for a notional expense.

61 Subsection (2AA) goes on to provide that a notional expense may only be used once in determining whether corresponding income arises.

62 New section 83(2AB) defines “notional expense” to mean an expense which has neither been paid nor is payable to another person and which is not deductible in computing the profits of the company under Case I (because it is notional) but would have been deductible if it had actually been paid. So a notional rent payment would

fall within this definition because had it actually been paid to another person it would have been a deductible expense under Case I.

63 New section 83(2AC) defines an inter-fund transfer as one between two funds of the company which is shown in line 14 of Form 58 in one fund's return and in line 33 of Form 58 in the others.

64 These changes have effect in relation to periods of account ending on or after 2 December 2004.

Apportionments and inherited estate

65 Articles 2, 3 and 6 of the Order make changes to the apportionment of income rules and the rules about the calculation of the policy holders' share of relevant profits. The object is to ensure that any assets of the company held in the long-term insurance fund which are surplus to the requirements of the company but which have not been distributed, are not treated as being referable to any of the categories of business of the company where the income and gains are exempt from corporation tax or otherwise not brought into account as such. They also ensure that the income and gains of those surplus assets are always charged to tax at the rate attributable to shareholders rather than at the lower policy holder's rate of corporation tax.

66 Article 3 amends section 432A. It does so by first of all amending subsection (6) so that it is applicable only to BLAGAB. It then, in subsection (6)(a)(ii), replaces the reference to the mean of the appropriate parts of the investment reserve with two new terms: one being the mean of the opening and closing Form 19 excess and the other the mean of the appropriate parts of the opening and closing free assets amounts.

67 Article 3(3) then inserts a new subsection (6A) into section 432A which applies to any category of business apart from BLAGAB. Paragraph (a) of this subsection is the same as paragraph (a) of section 432A(6) except that there is no reference, in this case, to the Form 19 excess, only to the opening and closing free assets amounts.

68 The denominator of the fraction given by section 432A(6A) is also changed so that it now refers to

- the numerator given by paragraph (a) for the category of business concerned
- the numerators also given by paragraph (a) of subsection (6A) for the categories other than BLAGAB and finally
- the numerator given by subsection (6) for BLAGAB.

In that way the denominator will consist of the entire long-term business.

69 As a consequence of the split of the old section 432A(6), section 432A(6)(b)(ii) is amended by article 3(2)(d) to refer to subsection (6A) for the numerators of the non BLAGAB categories.

70 Article 3(4) substitutes a new section 432A(8). This subsection provides a definition of "the Form 19 excess" used in the amended section 432A(6) to mean the amount shown in line 66 of Form 19 in the periodical return.

71 It also defines "the free assets amount" to mean the excess of the value of the company's long-term business assets over the aggregate of the value of the liabilities of that business (i.e. the mathematical reserves and the deposit back arrangements), together with any other money debts and the Form 19 excess.

72 It can be seen that the definition excluding the Form 19 excess is the same as the definition of "investment reserve" in the existing section 432A(8). So the Form

19 excess is carved out of the investment reserve and as a result of the new section 432A(6) and (6A) the Form 19 excess is always attributable to BLAGAB.

73 Also in the new section 432A(8) is a definition of “the appropriate part” in relation to the free assets amounts and this follows exactly the definition of “appropriate part” in relation to the investment reserve in the old section 432A(8).

74 Articles 3(5) and 8 make consequential amendments to section 432A(9)(b) and to paragraph 4 Schedule 19AA relating to the OLAB investment reserve.

75 Also inserted by article 3(4) are new sections 432A(8A) and (8B). They operate in a case where a company has, with the agreement of a regulator (and sometimes the Court), attributed its “inherited estate” between shareholders and policy holders. In some cases the inherited estate is held in a non-profit fund. Such a fund may be supporting a with-profits fund, both in the formal sense in that the company has obtained the FSA’s permission to use part or all of the assets of the non-profit fund as “support arrangements” shown on Form 19 line 27, or in a more general sense.

76 In such a case, there is deemed by section 432A(8A) to be an entry on line 27 of Form 19 equal to the excess assets in the non-profit fund. “Excess assets” is defined in section 432A(8B) to mean the fund carried forward figure in Form 40 line 59 for the fund less 105% of the mathematical reserves. If there is no separate Form 40 or 14 for the non-profit fund concerned, the figures will be those that would be in such forms had they been prepared.

77 Article 12 amends section 89 of the Finance Act 1989 in order to ensure that the income and gains of the Form 19 excess are charged to tax at 30%.

78 Article 12(2) amends section 89(1)(a) to ensure that in a case where there are no Case I profits for the period the policyholder share only includes the amount of the relevant profits after deducting the Form 19 excess fraction (which then falls within the charge to tax at 30%)

79 Article 12(3) makes amendments to section 89(1A)(b) to deal with a case where there is a Case I profit. In that paragraph it is now provided that the deduction from the Case I profit after deducting the Case VI profits is to be the aggregate of any remaining Case I profits of the company (as now) and the form 19 excess fraction proportion of the BLAGAB income and gains.

80 Article 12(4) then inserts a new section 89(1AA) to define the “Form 19 excess fraction” and that is the fraction $\frac{O}{N}$ where

- N is the BLAGAB section 432A numerator for the period, and
- O is what that numerator would be if only part of the mean Form 19 excess was included in the calculation of the numerator.

81 The relevant part (the “appropriate proportion”) can also be expressed as a fraction

$$\frac{A}{B} \text{ where}$$

- A is the BLAGAB part of the free asset amount, and
- B is the total free asset amount.

82 This calculation effectively gives the numerator that would be found using the existing version of section 432A(6), so the difference is the effect of allocating all the Form 19 excess to BLAGAB.

83 Article 12(5) then gives the tag “BLAGAB income and gains” to the description in section 89(1B). It is the amounts of income and gains referable to BLAGAB before deduction of expenses etc.

Recognised funds – section 83A FA 1989

84 Paragraph 12 of the Schedule amends section 83A FA 1989.

85 Paragraph 12(2) provides that apart from the revenue account for the whole business (section 83A(2)(a)) there is only otherwise recognised a “with-profits fund”. Paragraph 12(5) inserts a new section 83A(6) which show that “with-profits fund” has the meaning it has in PRU, namely—

- (a) a long-term insurance fund (or that part of such a fund) in which policy holders are eligible to participate in any established surplus; and
- (b) where it is an insurer’s usual practice to restrict policy holders’ participation in any established surplus to that arising from only a part of the fund (or part fund) falling within (a), that part (or that part of the part fund).

86 Paragraph 12(3) gives a new rule in new section 83A(3A) for the case where a with-profits fund for which a Form 40 is required to be prepared is included as part of another with-profits fund – called the “wider fund”. In such a case the wider fund is not looked at for the purposes of sections 82A to 83AB. The second sentence of section 83A(3A) deals with further nesting of with–profits funds.

87 Paragraph 12(4) substitutes a new section 83A(4) dealing with the residue of funds. Where there are with profits funds that together do not account for the whole long-term insurance fund, any balance, being a non-profit fund or funds, will make up the residual fund without any division where there is more than one fund. Note that in the case of a non-recognised wider fund where all the “sub-funds” are with profits, there is no residue, but the wider fund is still ignored.

88 Paragraph 12(6) gives the commencement rule – it is periods of account beginning on after 1 January 2005.

89 Paragraph 13 provides a transitional rule where the make up of recognised funds changes from one period to the next (the “new period”). Paragraph 13(1) does this by inserting a new section 83B into FA 1989. Where this happens, the section 432F(2) excesses carried forward at the end of the earlier period are allocated to the new recognised funds in an appropriate manner.

90 Paragraph 13(2) gives the commencement rule – it applies to new periods of account beginning on after 1 January 2005.

SCHEDULE 1

Section [j311-01]

INSURANCE COMPANIES ETC [j311-01s]

Expenses of insurance companies

- 1 (1) Section 76 of ICTA is amended as follows.
- (2) In subsection (8) (expenses attributable to basic life assurance and general annuity business for the purposes of Step 1 are to be those so attributable under proper internal accounting practice) in the second sentence (meaning of “proper internal accounting practice”) at the end of paragraph (b) insert “, or
 - (c) the Integrated Prudential Sourcebook.”.
- (3) The amendment made by this paragraph has effect in relation to periods of account ending on or after 31st December 2004.

Interpretative provisions relating to insurance companies

- 2 (1) Section 431(2) of ICTA is amended as follows.
- (2) Insert the following definition at the appropriate place –

“the Integrated Prudential Sourcebook” means the Integrated Prudential Sourcebook made by the Financial Services Authority under the Financial Services and Markets Act 2000;”.
- (3) For the definition of “liabilities” substitute –

“liabilities”, in relation to an insurance company, means –

 - (a) the mathematical reserves of the company as determined in accordance with chapter 7.3 of the Integrated Prudential Sourcebook, and
 - (b) liabilities of the company (whose value falls to be determined in accordance with chapter 1.3 of that Sourcebook) which arise from deposit back arrangements (within the meaning given by that Sourcebook);”.
- (4) Omit the definition of “long-term liabilities”.
- (5) For the definition of “value” substitute –

“value”, in relation to an asset of an insurance company, means the value of the asset as determined in accordance with chapter 1.3 of the Integrated Prudential Sourcebook;”.
- (6) The amendments made by this paragraph have effect in relation to periods of account ending on or after 31st December 2004.

Amendment of Chapter 1 of Part 12 of ICTA etc

- 3 (1) Section 431A of ICTA is amended as follows.
- (2) Renumber the section as subsection (1) of that section.
- (3) After that subsection insert –

- “(2) Where any exercise of a power under that Act has effect for a period ending on or before, or beginning before and ending after, the day on which an order containing an amendment in consequence of that exercise is made under subsection (1) above, the power conferred by that subsection includes power to provide for the amendment to have effect in relation to that period.”.

Apportionment of income and gains

- 4 (1) Section 432A of ICTA is amended as follows.
- (2) In subsection (9A) (meaning of “net value”) for “long-term liabilities” substitute “liabilities”.
- (3) The amendment made by this paragraph has effect in relation to periods of account ending on or after 31st December 2004.

Section 432B apportionment: participating funds

- 5 (1) Section 432E of ICTA is amended as follows.
- (2) In subsection (2A) (increase in amount determined under subsection (2) where amount is taken into account under subsection (2) of section 83 of FA 1989 by virtue of subsection (2B) of that section) in the opening words –
- (a) for “an amount is” substitute “an amount or amounts are”;
 - (b) after “subsection (2B) of that section” insert “or by virtue of section 444ACA(2) of this Act”.
- (3) In that subsection, for the definition of “RP” substitute –
- “RP is –
- (a) the amount taken into account under subsection (2) of section 83 of the Finance Act 1989 by virtue of subsection (2B) of that section;
 - (b) the amount so taken into account by virtue of section 444ACA(2) of this Act; or
 - (c) where amounts are so taken into account by virtue of both of those provisions, the aggregate of those amounts.”.
- (4) The amendments made by this paragraph have effect in relation to insurance business transfer schemes (within the meaning given by section 444AC(6) of ICTA) taking place on or after 2nd December 2004.

Transfers of business: modification of section 83(2) of FA 1989

- 6 (1) Section 444AC of ICTA is amended as follows.
- (2) In subsection (2) (excess of element of the transferee’s line 15 (or 31) figure representing the transferor’s long-term insurance fund over amount specified in paragraph (b) not to be regarded as other income of transferee) in paragraph (b) (amount of liabilities to policy holders and annuitants transferred to transferee) –
- (a) for “the amount” substitute “the aggregate amount”;
 - (b) at the end insert “and of any relevant debts”.
- (3) After that subsection insert –

- “(2A) Subject to subsections (2C) and (2D) below, subsection (2B) below applies if—
- (a) the aggregate amount of the liabilities to policy holders and annuitants transferred to the transferee and of any relevant debts, exceeds
 - (b) the element of the transferee’s line 31 figure representing the transferor’s long-term insurance fund.
- (2B) Where this subsection applies—
- (a) the excess is to be taken into account as a receipt of the transferee in computing in accordance with the provisions of this Act applicable to Case I of Schedule D the profits of its life assurance business for the period of account of the transferee in which the transfer takes place (“the relevant period of account”); and
 - (b) the relevant proportion of the excess is to be taken into account as a receipt of the transferee in so computing the profits of each category of its life assurance business for the relevant period of account;
- and, for this purpose, “the relevant proportion”, in relation to a category of the transferee’s life assurance business, is the proportion that the liabilities of that category that are transferred bear to the total liabilities transferred.
- (2C) Subsection (2B) above does not require the excess to be taken into account as a receipt of the transferee in so computing the profits of its life assurance business for the relevant period of account if—
- (a) transferred liabilities of an aggregate amount equal to the excess are not taken into account in so computing those profits for that period of account, and
 - (b) the amount of the closing liabilities of that period of account is taken into account as opening liabilities in so computing those profits for the next period of account.
- (2D) Subsection (2B) above does not require the relevant proportion of the excess to be taken into account as a receipt of the transferee in so computing the profits of a category of its life assurance business for the relevant period of account if—
- (a) transferred liabilities of an aggregate amount equal to the relevant proportion of the excess are not taken into account in so computing those profits for that period of account, and
 - (b) the amount of the closing liabilities of that period of account is taken into account as opening liabilities in so computing those profits for the next period of account.
- (2E) In subsections (2C)(a) and (2D)(a) above “transferred liabilities” means—
- (a) liabilities to policy holders or annuitants at the end of the relevant period of account that were transferred to the transferee, and
 - (b) payments made to discharge, during that period of account, liabilities to policy holders or annuitants that were transferred to the transferee.”.
- (4) After subsection (3) insert—

- “(4) In this section “relevant debts” means debts which become debts of the transferee’s long-term insurance fund as a result of the transfer.
- (5) In determining the amount of the liabilities transferred for the purposes of this section, there is to be disregarded any reduction in the transferee’s liabilities resulting from reinsurance under a contract of reinsurance which is a relevant financial reinsurance contract (within the meaning of section 82C of the Finance Act 1989).
- (6) For the purposes of this section and section 444ACA “insurance business transfer scheme” includes a scheme which would be such a scheme but for section 105(1)(b) of the Financial Services and Markets Act 2000 (which requires the business transferred to be carried on in an EEA State).”.
- (5) The heading of the section accordingly becomes “Transfers of business: excess of assets or liabilities”.
- (6) The amendments made by this paragraph have effect in relation to insurance business transfer schemes (within the meaning given by section 444AC(6) of ICTA) taking place on or after 2nd December 2004.
- (7) But in relation to a period of account beginning before 1st January 2005, section 444AC(2A)(b) of ICTA shall have effect as if for “line 31 figure” there were substituted “line 15 figure”.

Transfers of business: transferor shares are assets of transferee’s long-term insurance fund etc

- 7 (1) After section 444AC of ICTA insert—

“444ACA Transfers of business: transferor shares are assets of transferee’s long-term insurance fund etc

- (1) This section applies where an insurance business transfer scheme (see section 444AC(6)) has effect to transfer long-term business from one company (“the transferor”) to another (“the transferee”).
- (2) If—
- (a) the assets of the long-term insurance fund of the transferee comprise or include relevant shares or an interest in such shares, and
 - (b) the fair value of the relevant shares, or of that interest, is reduced (whether or not to nil) as a result of the transfer,
- an amount equal to that reduction in fair value is to be taken into account under section 83(2) of the Finance Act 1989 as a receipt of the transferee of the period of account of the transferee in which the transfer takes place.
- (3) In subsection (2) “relevant shares” means—
- (a) some or all of the shares in the transferor, or
 - (b) some or all of the shares in a company (whether or not an insurance company) which beneficially owns, directly or indirectly,—
 - (i) some or all of the shares in the transferor, or
 - (ii) an interest in some or all of those shares.

- (4) In subsection (2) “fair value” has the meaning given by section 444AB(6).”.
- (2) The amendment made by this paragraph has effect in relation to insurance business transfer schemes (within the meaning given by section 444AC(6) of ICTA) taking place on or after 2nd December 2004.

Equalisation reserves for general business

- 8 (1) Section 444BA of ICTA is amended as follows.
- (2) In subsection (11) (meaning of “equalisation reserves rules”) for “Chapter 6 of the Prudential Sourcebook (Insurers)” substitute “chapter 7.5 of the Integrated Prudential Sourcebook”.
- (3) The amendment made by this paragraph has effect in relation to periods of account ending on or after 31st December 2004.

Unappropriated surplus on valuation

- 9 (1) Section 82B of FA 1989 is amended as follows.
- (2) In subsection (1) (section to apply where insurance company has unappropriated surplus on valuation and has not made an election in accordance with Rule 4.1(6) of the Prudential Sourcebook (Insurers) for the period of account in question) in paragraph (b), for “Rule 4.1(6)” substitute “Rule 9.10(c)”.
- (3) The amendment made by this paragraph has effect in relation to periods of account ending on or after 31st December 2004.

Relevant financial reinsurance contracts

- 10 (1) Section 82C of FA 1989 is amended as follows.
- (2) In subsection (1) (cases where section applies) in paragraph (b), for “either condition A or condition B” substitute “condition A”.
- (3) Omit subsections (4), (5), (8) and (9) (provisions relating to condition B).
- (4) The amendments made by this paragraph have effect in relation to insurance business transfer schemes (within the meaning given by section 82C(9) of FA 1989) taking place on or after 2nd December 2004.

Receipts to be taken into account

- 11 (1) Section 83 of FA 1989 is amended as follows.
- (2) In subsection (2A) (amounts not required to be taken into account by subsection (2)) for paragraph (a) (amounts which are entirely notional) substitute—
- “(a) comprises notional income for the period of account (see subsection (2AA)),
- (aa) represents an inter-fund transfer (see subsection (2AC)),”.
- (3) After that subsection insert—

- “(2AA) For the purposes of subsection (2A)(a) above, an amount brought into account as mentioned in paragraphs (a) to (d) of subsection (2) above for a period of account is to be regarded as notional income for the period of account if—
- (a) it represents income which has not been received, and is not receivable, from another person, and
 - (b) a corresponding notional expense of the same amount is brought into account in the period of account;
- and where particular income falls to be regarded as notional income under this subsection, the notional expense by virtue of which that income falls to be so regarded may not be taken into account for determining whether any other income is to be so regarded.
- (2AB) In subsection (2AA) above “notional expense” means an expense which has not been paid, and is not payable, to another person and which—
- (a) is not deductible in computing the profits of the company in respect of its life assurance business in accordance with the provisions of the Taxes Act 1988 applicable to Case I of Schedule D, but
 - (b) had it represented an amount paid or payable to another person, would have been so deductible.
- (2AC) In subsection (2A)(aa) above “inter-fund transfer” means a transfer between two funds which is shown in the company’s periodical return—
- (a) in the case of one of the funds, in line 14 of the Form 58 for that fund, and
 - (b) in the case of the other fund, in line 33 of the Form 58 for that fund.”.
- (4) The amendments made by this paragraph have effect in relation to periods of account ending on or after 2nd December 2004.

Meaning of “brought into account”

- 12 (1) Section 83A of FA 1989 is amended as follows.
- (2) In subsection (2) (accounts which are recognised for the purposes of sections 82A to 83AB)—
- (a) in paragraph (b) (separate revenue account prepared under Chapter 9 of the Prudential Sourcebook (Insurers) in respect of a part of the company’s long-term business to be a recognised account) for “part of that business” substitute “with-profits fund (see subsection (6))”;
 - (b) omit the words from “Paragraph (b) above” to the end of the subsection.
- (3) After subsection (3) insert—
- “(3A) But where—
- (a) there is prepared such a separate account in respect of a with-profits fund (“the sub-fund”), and
 - (b) the sub-fund forms part of another with-profits fund (“the wider fund”) in respect of which such a separate account is also prepared,

the account in respect of the wider fund shall not be a recognised account for the purposes of those sections.

And where there is prepared such a separate account in respect of a with-profits fund which forms part of the sub-fund, nothing prevents this subsection from having effect in the case of the sub-fund as it has effect in the case of the wider fund (and so on).”.

(4) For subsection (4) substitute –

“(4) If –

- (a) a company prepares a revenue account in respect of the whole of its long-term business (“the main account”),
- (b) it prepares one or more such separate accounts as are mentioned in subsection (2)(b) above, and
- (c) the total of the items brought into account in the separate accounts, other than any such accounts which by virtue of subsection (3A) above are not recognised accounts for the purposes of those sections, is not equal to the total amount brought into account in the main account,

there shall be treated as having been required and prepared a further separate revenue account covering the balance.”.

(5) At the end of the section insert –

“(6) In this section “with-profits fund” has the same meaning as in the Integrated Prudential Sourcebook.”.

(6) The amendments made by this paragraph have effect in relation to periods of account beginning on or after 1st January 2005.

Changes in recognised accounts: attribution of amounts carried forward under s.432F of ICTA

13 (1) After section 83A of FA 1989 insert –

“83B Changes in recognised accounts: attribution of amounts carried forward under s.432F of Taxes Act 1988

- (1) This section applies to a company where any revenue account that is recognised for a period of account (the “new period of account”) relates to funds or business which is different from the funds or business to which a revenue account that was recognised for the preceding period of account relates.
 - (2) Any subsection (2) excess (within the meaning of section 432F(2) of the Taxes Act 1988) which would have been available under section 432F(3) or (4) of that Act to reduce a subsection (3) figure (within the meaning of section 432F(1) of that Act) of the company in the new period of account shall be attributed between the revenue accounts that are recognised for that period of account in such manner as is appropriate.
 - (3) In this section “recognised” means recognised, by virtue of section 83A, for the purposes of sections 82A to 83AB.”.
- (2) The amendment made by this paragraph has effect in relation to new periods of account (within the meaning given by section 83B(1) of FA 1989) beginning on or after 1st January 2005.

2004 No.

INCOME TAX

The Insurance Companies (Corporation Tax Acts) Order 2004

Made - - - - December 2004

Laid before the House of Commons December 2004

Coming into force - - 1st January 2005

In exercise of the powers conferred upon them by section 431A of the Income and Corporation Taxes Act 1988(a) the Treasury, being satisfied that it is expedient to amend Chapter 1 of Part 12 of that Act in consequence of the exercise of powers by the Financial Services Authority under the Financial Services and Markets Act 2000(b), and to amend the Tax Acts, in their application to insurance companies, in consequence of those amendments, make the following Order:

Citation, commencement and effect

1. This Order may be cited as the Insurance Companies (Corporation Tax Acts) Order 2004, shall come into force on 1st January 2005, and shall have effect in respect of periods of account beginning on or after 1st January 2005

Amendment of Chapter 1 of Part 12 of the Income and Corporation Taxes Act 1988

2. Chapter 1 of Part 12 of the Income and Corporation and Taxes Act 1988 is amended as follows.

3.—(1) Amend section 432A(c) (apportionment of income and gains) as follows.

(2) In subsection (6)—

(a) in the words before paragraph (a) for “a category of business” substitute “basic life assurance and general annuity business”

(b) at the end of paragraph (a)(i) omit “and”;

(c) for subparagraph (ii) of paragraph (a) substitute—

“(ii) the mean of the opening and closing Form 19 excess; and

(iii) the mean of the appropriate parts of the opening and closing free assets amounts;” and

(d) in paragraph (b)(ii) for “that paragraph” substitute “subsection (6A)(a)”.

(3) After subsection (6) insert—

(a) 1988 c. 1. Section 431A was inserted by paragraph 2 of Schedule 6 to the Finance Act 1990 and amended by article 27 of S.I. 2001/3629.

(b) 2000 c. 8.

(c) Section 432A was inserted by paragraph 6 of Schedule 6 to the Finance Act 1990. Relevant amendments are those made by section 109 of the Finance Act 2000 (c. 17) and article 52(2)(c) of S.I. 2001/3629.

“(6A) For the purposes of subsection (5) above “the relevant fraction” in relation to any other category of business is the fraction of which—

- (a) the numerator is the aggregate of—
 - (i) the mean of the opening and closing liabilities of the category, reduced (but not below nil) by the mean of the opening and closing net values of any assets directly referable to the category, and
 - (ii) the mean of the appropriate parts of the opening and closing free assets amounts; and
- (b) the denominator is the aggregate of—
 - (i) the numerator given by paragraph (a) above;
 - (ii) the numerators given by that paragraph in relation to the other categories of business to which this subsection applies; and
 - (iii) the numerators given by subsection (6) above in relation to the company’s basic life assurance and general annuity business.”.

(4) For subsection (8) substitute—

“(8) In subsections (6) and (6A) above—

“the free assets amount”, in relation to an insurance company, means the excess of the value of the assets of the company’s long-term business over the aggregate of —

- (a) the value of the liabilities of that business,
- (b) any money debts (within the meaning of Chapter 2 of Part 4 of the Finance Act 1996) of the company not falling within paragraph (b) of this definition which are owed in respect of that business, and
- (c) the Form 19 excess;

“the Form 19 excess” means (subject to subsection (8A) below) the amount of assets shown on line 66 of Form 19 in the periodical return; and

“appropriate part” in relation to the free assets amount means—

- (a) where none (or none but an insignificant proportion) of the liabilities of the long-term business are with-profits liabilities, the part of that amount which bears to the whole the proportion A/B

where—

A is the amount of the liabilities of the category of business in question;

B is the whole amount of the liabilities of the long-term business; and

- (b) in any other case that part of the free assets amount which bears to the whole the proportion C/D

where—

C is the amount of the with-profits liabilities of the category of business in question; and

D is the whole amount of the with-profits liabilities of the long-term business.

(8A) In a case where—

- (a) the company has reattributed the inherited estate (within the meaning of the Integrated Prudential Sourcebook); and
- (b) some or all of the inherited estate attributable to shareholders is held in a fund of the company’s long-term insurance fund relating only to non-participating business

there shall be deemed to be an entry in line 27 of Form 19 equal to the value of the excess assets in any non-participating fund in which assets representing the reattributed inherited estate of the company are held.

(8B) For the purpose of subsection (8A)—

“reattributed inherited estate” means such an estate as has been the subject of an agreement with the relevant regulator as to—

- (a) its amount; and
- (b) its attribution between shareholders and policy holders;

“excess assets” in relation to a non-participating fund means the amount by which—

- (a) the figure in line 59 of Form 40 (fund carried forward) for the fund exceeds,
- (b) 105% of the figure of mathematical reserves in line 11 of Form 14 for the fund, less any amount otherwise shown in line 27 of Form 19 which relates to the fund

Here “the relevant regulator” means the Financial Services Authority, the Treasury or the Department for Trade and Industry as the case requires.”.

(5) In subsection (9)(b)(a) for “investment reserve as defined in paragraph 4(2)(a)” substitute “free assets amount as defined in paragraph 4(5)”.

4.—(1) Amend section 432E(b) as follows.

(2) At the end of subsection (1) add “but subject to 432G below”.

5. After section 432F insert—

“Section 432B: apportionment of business transfer-in

432G.—(1) This section applies where an amount falls within section 83(2)(e) of the Finance Act 1989.

(2) Where—

- (a) this section applies, and
- (b) it is necessary in accordance with section 83 to determine what part of a business transfer-in is referable to life assurance business or any category of life assurance business,

a business transfer-in shall be apportioned to the categories of business of the transferee in the proportions which the amount of the liabilities transferred for each of those categories bear to the whole of the liabilities transferred.”.

6.—(1) Amend section 444AC(c) (transfers of business: modification of section 83(2) of the Finance Act 1989) as follows.

(2) In subsections (2) and (3)—

- (a) for “line 15 figure” substitute “line 31 figure”; and
- (b) for “as other income” substitute “as business transfers-in”.

7. In section 444AD (transfers of business: modification of section 83(2B), in subsection (4)(b) for “line 15 figure” substitute “line 31 figure”.

8.—(1) In Schedule 19AA to the Income and Corporation Taxes Act 1988, paragraph 4 is amended as follows.

(2) In sub-paragraph (1), in the definition of “B”, and in sub-paragraphs (2) and (5) for “investment reserve” substitute “free asset amount”.

Consequential amendment of the Finance Act 1989

9. Amend the Finance Act 1989(a) as follows.

(a) Subsection (9) was substituted by paragraph 13 of Schedule 8 to the Finance Act 1995.

(b) Section 432E was inserted by paragraph 4 of Schedule 6 to the Finance Act 1990, and relevantly amended by paragraphs 16 and 17 of Schedule 8 to the Finance Act 1995 and paragraph 10 of Schedule 33 to the Finance Act 2003.

(c) This section and section 444AD were inserted by paragraph 20(1) of Schedule 33 to the Finance Act 2003.

10.—(1) Amend section 83(b) (receipts to be taken into account in computing profits of a life assurance company chargeable to Case I of Schedule D) as follows.

(2) In subsection (2)—

(a) at the end of paragraph (c) omit “or”;

(b) at the end of paragraph (d) add—

“; or

(e) business transfers-in.”

(3) In subsection (2A) for “paragraphs (a) to (d)” substitute “paragraphs (a) to (e)”.

(4) In subsection (2B) after “total expenditure” insert “, or as a business transfer-out, ”.

11.—(1) Amend section 83ZA as follows.

(2) In subsection (10)(b) and (12) for “line 15 figure” substitute “line 31 figure”.

(3) In subsection (12) for “as other income” substitute “as business transfers-in”.

12.—(1) Amend section 89 (policy holder’s share of profits) as follows.

(2) In subsection (1)(a) after “the relevant profits” insert—

“less the Form 19 excess fraction of the BLAGAB income and gains”

(3) In subsection (1A)(b)—

(a) after “deducting” insert “the aggregate of— (i)”; and

(b) after “life assurance business” insert—

“, and

(ii) the Form 19 excess fraction of the BLAGAB income and gains of the company for the period,”.

(4) After subsection (1A) insert—

“(1AA) For the purposes of subsections (1) and (1A) above the “Form 19 excess fraction” of the BLAGAB income and gains means the fraction O/N where—

N is the numerator given by section 432A(6) for the period, and

O is the numerator which would be given by that subsection were only the appropriate proportion of the mean of the opening and closing Form 19 excesses included in its calculation.

Here “the appropriate proportion” is the same proportion of the Form 19 excess which the part of the free asset amount referable to basic life and general annuity business (found in accordance with 432A(6)(a)(iii)) bears to the total of that amount.”.

(5) In subsection (1B) after “the company’s basic life assurance and general assurance business” insert “(the BLAGAB income and gains)”.

Consequential amendment of statutory instrument

13. In article 52(2)(c) of the Financial Services and Markets Act 2000 (Consequential Amendments) (Taxes) Order 2001(c) omit “, (8)(a) (twice) and (b)”.

Name

Name

Address

Two of the Lords Commissioners of Her Majesty’s Treasury

(a) 1989 c. 26.

(b) Section 83 was substituted by paragraph 16(1) of Schedule 8 to the Finance Act 1995 and subsequently amended. The relevant amendments are those made by paragraph 2 of Schedule 33 to the Finance Act 2003.

(c) S.I. 2001/3629.

EXPLANATORY NOTE

(This note is not part of the Order)

This Order amends Chapter 1 of Part 12 of the Income and Corporation Taxes Act 1988 (c. 1: “ICTA”) in consequence of the adoption by the Financial Services Authority, under the powers conferred upon the Authority by the Financial Services and Markets Act 2000 (c. 8), of an integrated prudential sourcebook for determining the solvency of insurance companies.

Article 1 of the Order provides for its citation commencement and effect.

Article 2 introduces the amendments to Chapter 1 of Part 12 of ICTA.

Article 3 amends section 432A of ICTA to provide for separate treatment for basic life assurance and general annuity business on the one hand and other categories of business on the other. As a consequence of these changes (involving amendment to subsection (6) and the insertion of a new subsection (6A)) subsection (8) (which provides for interpretation) is replaced in its entirety.

Article 5 inserts a new section 432G of ICTA which specifies the manner of apportioning the amount of a business transfer-in for the purposes of section 432B where section 83(2)(a) of the Finance Act 1989 applies. Article 4 makes a consequential amendment to section 432E, which is subject to section 432G.

Articles 6 and 7 make amendments to sections 444AC and 444AD of ICTA in consequence of the restructuring of the Form 40 required to be delivered with the return deposited with the Financial Services Authority under section 9.6 of the Prudential Sourcebook (Insurers).

Article 8 makes amendments to Schedule 19AA to ICTA (which forms part of Chapter 1 of Part 12) as a consequence of the introduction of the concept of the free asset amount.

Article 9 introduces, and Article 10 to 12 make consequential amendments to sections 83, 83ZA and 89 of the Finance Act 1989.

Article 13 makes a consequential amendment to article 52 of the Financial Services and Markets Act 2000 (Consequential Amendments) (Taxes) Order 2001 to remove a reference which is spent in consequence of the substitution of section 432A(8) by article 3 above.

This Order does not impose new costs on business.