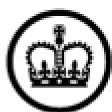


HM Revenue
& Customs

Draft Guidance – December 2018
Life Assurance Manual

The following draft guidance covers the Corporation Tax treatment of insurance companies writing life assurance and other long-term insurance business.

It explains the application of the legislation introduced in Finance Act 2012 effective from 1 January 2013. This guidance does not include changes introduced by Finance Act 2017. This and additional material on friendly societies and mutuals will be incorporated in due course.

Comments on this draft guidance are invited by Friday 22 February 2019 and should be sent to lamguidance.lbscotlandandni@hmrc.gsi.gov.uk

Life Assurance Manual
Draft Guidance Contents

LAM01000: Introduction and long-term insurance business overview

LAM02000: I-E overview

LAM03000: I-E - Calculation of 'I' Income and Chargeable Gains

LAM04000: Calculating ‘E’ – ‘adjusted BLAGAB management expenses’ FA2012/76

LAM05000: Apportionment rules

LAM06000: I-E Profit: Calculation of the tax charge

LAM07000: Trade profits

LAM08000: Full example computation

LAM09000: Double Tax Relief

LAM10000: Reinsurance

LAM11000: Long-term Business Fixed Capital

LAM12000: International and cross border

LAM13000: Transfer of long-term business

LAM14000: Finance Act 2012 and Transitional Provisions

LAM15000: Excess expenses, losses and deficits

LAM01000: Introduction and long-term insurance business overview

LAM01010 Introduction to this manual

LAM01060 Background and purpose

LAM01070 Types of life insurance products

LAM01080 Taxation of products

LAM01090 Life insurance regulation: solvency II, PRA and FCA

LAM01100 Life company accounting: basic overview

LAM01110 Introduction of the FA2012 life tax regime

LAM01120 Commercial background to the tax regime

LAM01130 Key concepts: a simplified overview

LAM01140 Key concepts: tax definitions of business categories

LAM01150 Key concepts: tax definitions of 'contract of insurance', 'contract of long-term insurance' and 'insurance company'

LAM01160 Key concepts: simplified example of the I-E calculation

LAM01170 Background to the introduction of FA2012 life tax regime

LAM01180 Abbreviations

LAM01010: Introduction to this manual

This manual provides guidance on the corporation tax treatment of insurance companies writing life assurance and other long-term insurance business. The guidance relates to the life tax regime introduced in Finance Act 2012 effective from 1 January 2013. The manual covering the regime prior to 2013 is archived and still available.

The tax treatment of life insurance policyholders is set out in the Insurance Policyholder Taxation Manual (IPTM). The tax treatment of pension policyholders is set out in the Pensions Tax Manual. Issues related to general insurance (property & casualty) are set out in the General Insurance Manual (GIM).

The manuals are primarily written for the guidance of HMRC staff and are intended to be used by insurers and their advisers. This manual is relevant to companies writing life assurance and other long-term business as defined in FA2012/S56 and FA2012/S63.
The terms 'life insurance' and 'life assurance' are normally interchangeable and 'life insurance' is generally used in this manual except where the specific definition of life assurance for tax purposes is being referred to.

LAM01060: Long-term insurance business overview: background and purpose

This section outlines the context for the evolution of the life tax regime.

The special tax regime for life insurance has evolved in response to the legal, regulatory and accounting treatment of life companies. It is also linked to the tax basis for individual policyholders which will vary depending on the nature of the product.

An understanding of:

- the regulatory regime
- life company accounting
- the nature of the products and their tax treatment

is important to gaining an understanding of life company taxation.

All of these have been subject to major change in recent years with further developments expected, for example, in accounting in IFRS17.

The current tax regime was introduced from 1 January 2013. Some change was essential. The starting point for the trading profit in the tax computation had been the insurance regulatory 'PRA' return. The planned introduction of the new EU Solvency II regulatory regime (effective from 1 January 2016) meant that tax legislation referring to the PRA return would be ineffective. The legislation in FA2012 addressed the need for change and facilitated the introduction of a regime more closely aligned with accounting and commercial practice.

The regime arises in part from the longstanding objective of the corporate tax system to tax within the insurance company both:

- the trading profit of the company
- the investment return accruing in the company for the benefit of policyholders with certain types of policies

This approach enables:

- administrative simplicity: collection of tax from a finite numbers of insurers rather than from a large number of policyholders
- Exchequer cash flow benefits by collection of tax up front rather than when policies mature
- Avoiding double taxation by ensuring no basic rate tax is charged on policyholder gains on maturity

This leads to the need for legislation to specify how the 'policyholder' corporation tax on investment return is charged and how the policies to be taxed in this way are to be identified.

The taxation of the policyholder is explained in the policyholder tax manual.
A brief summary of the main types of products and the associated regulatory, tax and accounting treatment are set out on the following pages LAM01070, LAM01080, LAM01090 and LAM01100. These are intended as an overview to assist in understanding the structure of the tax regime and are not intended to be comprehensive.

LAM01070: Long-term insurance business overview: types of life insurance products

There is no single legal definition of insurance. Commentary on the main characteristics of insurance and the different types of insurance is set out in the General Insurance Manual (GIM). FA2012/S64 links the definition of a ‘contract of insurance’ and a contract of long-term insurance to the regulatory definitions.

General insurance policies will pay out to indemnify loss in events such as fire, accident and theft and are normally for a one year term. Life insurance policies can run for many years with pay-out contingent, to varying extents, on human life: for example pay-out on death of the insured or pension annuities payable during the annuitant’s lifetime.

In commercial terms, life companies write two main types of business (and often hybrids of both):

- protection type policies where pay-out is mainly dependent on human life or may relate to incapacity or diagnosis of terminal illness
- savings policies, where regular or one-off investments are made in life policies which may pay out at a specified future date, on surrender or on earlier death. The element of dependency on human life must be there as a lesser or a minimal element of the policy

Examples of long-term insurance savings policies are:

1. Life insurance bonds: typically regular or single premium products with a specified term in excess of a year, with earlier pay-out on surrender or death
2. Personal pensions including stakeholder pensions (pension savings)
3. Corporate pension schemes

Personal pensions and corporate pensions are examples of pension accumulation products, where policyholders (and in some cases their employers) are saving for their retirement. There are also pension de-cumulation products which are set up to enable policyholders to draw pension benefits to provide funds on retirement. Pension annuities are one example as are pension draw down products.

Some products, such as annuities, have significant elements of dependency on human life while at the same time providing an investment type return to policyholders. Pension annuities are the most common type of annuity and guarantee an income for life in return for a lump sum up front.

Any of these types of products may be written as unit-linked, with profit or non- profit policies. A unit-linked policy typically links the benefits under the policy to the value of a specified fund or pool of assets and are generally priced on a daily basis. With profit policies aim to provide a smoothed investment return and the benefits are paid from within a designated 'With Profit Fund' in the life company. Non-profit policies is a term often used to refer to policies not within the unit-linked or with profit categories. Further explanations are in LAM05000.

Examples of protection products are:

- Term assurance with the premium fixed for a specified term and pay-out only on death
- Permanent Health Insurance 'PHI' in return for a regular premium over a period of more than a year, provides a pay-out on illness or incapacity. This is long-term business for regulation but not life insurance for tax purposes (See LAM01140 for definitions)

Life policies are a contract between the insurer and the policyholder. The insurer receives the premium in exchange for paying out amounts determined under the contract in specified circumstances. Any underlying assets purchased by the life company to support the payment of claims are beneficially owned by the company, not the policyholder. This is not withstanding that policy pay-outs may be directly linked to the value of specific assets held by the insurance company.

Insurance companies are prohibited by regulation from carrying out business other than insurance business. Most insurers are only authorised to carry out either long-term business or general insurance business. There are a small number of 'composite' insurers, writing general and long-term business but such composite licences are no longer granted.
There is a specific definition of life assurance for tax purposes in FA2012/S56 linked to the regulatory definitions of long-term business but not including all types of long-term insurance business. LAM01140 explains the definitions of long-term business and life assurance business and the difference between the two which are important for tax purposes

LAM01080: Long-term insurance business overview: taxation of products

The pay-out to policyholders on savings products (other than on death) is generally related to the premium paid and investment returns. How this is calculated depends on the policy terms. If this investment return was earned by an individual outside of a life policy, by holding investments directly, then tax may be due on investment income and capital gains (subject to allowances and exemptions).

The investment return accrues to the life company and, subject to some exceptions, is taxed within the life company. This is broadly a proxy for tax that would be payable by a basic rate taxpayer if the underlying investments were held directly. This is the justification for the so called 'I-E' tax basis which is explained in LAM02000. Policies that fall within the definition of Basic Life Assurance and General Annuity Business, more commonly referred to as 'BLAGAB' will be taxed on their I-E profits.

Not all savings policies are taxed as BLAGAB. FA2012/S57 lists the exclusions of life assurance business from the definition of BLAGAB. LAM01140

Policies such as pension savings policies, ISA account business and overseas life assurance business are excluded from the definition of BLAGAB business. These types of policies benefit from falling outside the I-E basis. This is because individuals holding such investments through other vehicles would not be subject to income tax or capital gains tax on accrual of investment return, for example, in an ISA account. For pensions the policyholder (subject to limits) receives a tax deduction up front for contributions and is not taxed on the income and gains rolled up over the life of the savings policy. Instead the policyholder is taxed when funds are withdrawn from the policy or on receipt of income from a pension annuity purchased from the proceeds.

Overseas life assurance business is excluded on the basis that the policyholder is non UK resident and would not have a tax liability on income and gains.

Protection business is excluded on the basis that it does not include an investment return element for the policyholders and is therefore a 'risk' product. These policies, from 1 January 2013, are taxed on a trading basis in the same way as general insurance policies.
The investment return on non-BLAGAB policies remains taxable income in the life company as part of the trading profit calculation. The trading profit is taxed after allowing a deduction for claims paid and future liabilities to policyholders, which will include the investment return passed on to policyholders. Effectively then, to the extent that the investment return is reserved for policyholders, there is no net corporation tax liability on the company on this income.

LAM01090: Long-term insurance business overview: life insurance regulation: Solvency II, PRA and FCA

Companies writing insurance business in the UK through a company or a branch in the UK are subject to prudential regulation by the PRA, or in some cases for EEA companies, by an EEA regulator. In the UK regulation of conduct is undertaken by the FCA.
Insurance regulation typically comes from two sources:

- The European Insurance and Occupational Pensions Authority (EIOPA) is the primary driver of European insurance regulation. It writes a variety of prudential and conduct regulations into European Law using EU Directives. These are then accepted for implementation in U.K. law by the Government
- The Treasury and UK Government can also write UK insurance regulations independent of the EU

The PRA and FCA are responsible for ensuring that insurance regulation is appropriately drafted and followed. This is done through PRA rule books and FCA handbooks. The application of EU regulation is dependent on the status of the UK within the EU.
As well as regulation at the legal entity level, there is regulation at group level within the EEA with a lead regulator identified generally in the territory where the headquarters or main operating company is based.

For regulatory purposes insurance is divided between:

- long-term insurance, described in Part II Schedule 1 to the FSMA 2000 (Regulated Activities) Order SI 2001/544 (PDF 182KB) ('RAO')
- general business described in Part I Schedule 1 RAO

This distinction is recognised for tax purposes. FA2102/S64 links the definition of a 'contract of insurance' and a 'contract of long-term insurance' for the purpose of Part 2 of FA2012, to the definitions in FSMA 2000 (Regulated Activities) Order SI 2001/544. Further information on regulated insurers is available in the General Insurance Manual (GIM).

Regulation of life insurers has evolved over many years, to protect the interests of policyholders. Life insurance products may involve premiums paid up front with pay-outs taking place many years later – in the case of some pension products up to 50 years or more after the policy is first taken out. It is therefore particularly important that policyholders have assurance that the company will be able to meet their claims over such long time periods.

EU regulation under the Solvency II Directives introduced a new system of prudential regulation effective from 1 January 2016 which applies to all insurers except the smallest entities. Solvency II (SII) imposes revised requirements on companies as to the quality and amount of capital they must hold to provide assurance that they can meet obligations to policyholders in times of financial stress. SII built on risk based capital requirements which had already been in place in the UK for a number of years. SII also applies harmonised standards across the EEA for risk management, governance and regulatory reporting.

In the past policyholder protection developed by designating assets held by the insurance company that were 'ring fenced' for meeting claims from policyholders on long-term business. This ring fenced fund of assets and liabilities was referred to as the 'Long-term Insurance Fund', with assets outside that fund commonly referred to as the 'Shareholder Fund'.

For prudential regulatory purposes, under Solvency II, there is no concept of a long-term insurance fund with all assets included in the prudential return available to meet obligations to policyholders and support the solvency position of the company.

A life company may have a number of designated sub-funds identified as backing specific types of policies or groups of policyholders. The assets (and liabilities) may be segregated. These are referred to as “ring fenced funds”. The most common are 'With Profit' funds where profits of the business are shared with policyholders, typically in a 90:10 or 100:0 Policyholder:Shareholder split. Only a few companies still actively write with profit business but the historic funds remain and there is therefore still a significant amount of with profit business in life companies. More information on with-profit funds is in LAM05070.

Note that none of these 'funds' have legal personality. They are all internally designated funds within the single corporate entity. In some cases the rules governing the fund may be specified in the Articles of Association of the company. With-profits funds will have published Principles and Practices of Financial Management. In other cases specific funds may be set up and/or governed by the terms of a Scheme of Arrangement approved by a court. Each company will have its own specific arrangements.

Although the PRA prudential regulation has most relevance for tax, an awareness of the conduct regulation and concepts such as 'Treating Customers Fairly' is helpful background. Details of regulations and summaries of the concepts for PRA and FCA are available on their websites. Insurer's regulatory returns the 'Solvency and Financial Condition Report' are also a good source of information on the business.

LAM01100: Long-term insurance business overview: life company accounting - basic overview

Life companies produce financial information both for regulatory solvency purposes as well as for financial reporting purposes. Until 31 December 2012, profits for inclusion in tax returns were based on the insurance regulatory returns for life companies. From 1 January 2013 onwards, taxable profits are based on accounting profits.

Understanding the accounts and making use of the information in published financial statements is important as the accounts feed directly into taxable profits and information disclosed is helpful in considering the tax return. There are important differences between life insurance company accounts and other sets of accounts and the impact of accounting on the tax computation is explored in more detail within each relevant chapter.

The consolidated accounts for listed insurance groups must be prepared using International Financial Reporting Standards (IFRS). The individual entity accounts for UK insurance companies that are used for tax purposes may report under one of three bases:

- IFRS
- UK GAAP – FRS 101 (essentially IFRS recognition and measurement requirements but with reduced disclosures and presented in the format required by the Companies Act)
- UK GAAP – FRSs 102 and 103 (again, presented in the format required by the Companies Act). FRS 103 Insurance Contracts has been effective from 1 January 2015 onwards and was updated in May 2016 for the impact of Solvency II. The standard includes definitions of insurance contract and insurance risk, and consolidates financial reporting requirements for insurance contracts from both IFRS and previous UK GAAP

The provisions of the European Insurance Accounts Directive were implemented in the UK by the Companies Act 1985 but are now found in Schedule 3 to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI2008/410) (the 'accounting Regulations') made under the Companies Act 2006.
The accounting Regulations lay down the required formats for the balance sheet and income statement (profit and loss account) for UK GAAP.
The main features to be aware of when reviewing an insurance company's accounts include:

4. **For UK GAAP only**, the income statement is divided into the 'technical' and 'non-technical' accounts. The distinction is not precise but broadly the technical account presents the results of the long-term insurance business and the non-technical account includes other income and expenses

5. For UK GAAP and IFRS
6. deferred acquisition expenses are often a material item in the accounts due to the long-term nature of the policies
7. certain policies, such as unit-linked bonds, are not regarded as insurance for accounts purposes ; these are treated as 'investment contracts' with only the fees charged within the policy treated as income and the investments held on balance sheet as policyholder deposits
8. technical provisions for insurance liabilities may differ between the accounts and insurance regulatory calculations. The established basis of accounting for long-term business in the UK which has generally been applied is the Modified Statutory Solvency Basis (MSSB)

this essentially represents the provisions made for regulatory purposes prior to Solvency II (the SSB), modified by certain adjustments for accounting purposes. Subsequent to the move to FRS 103, however, insurers have been permitted to make improvements to their accounting policies so while the MSSB may still be the foundation it no longer necessarily functions as a consistent requirement

9. for UK GAAP companies that have with-profits funds will have a 'Fund for Future Appropriations' (FFA) on the balance sheet, representing the surplus in the fund that has not yet been allocated between policyholders and shareholders. For IFRS, instead of an FFA, there may be an 'Unallocated Divisible Surplus' (UDS). Often this is presented within liabilities, rather than being separately disclosed on the face of the balance sheet

In IFRS the accounting standard that addresses insurance accounting is IFRS 4 Insurance Contracts. Significantly, IFRS 4 generally permits insurers to continue to use the accounting policies approved in their home state. This means that broadly the basis of accounting is often the same or similar to that applied under UK GAAP with the main differences highlighted As is the case under UK GAAP (FRS 103), insurers may adopt improved accounting policies if they make the financial reporting more relevant without adversely affecting reliability, or more reliable without adversely affecting relevance.

In 2017 the International Accounting Standards Board issued a new accounting standard for insurance contracts: IFRS 17. This was the culmination of a long running project to introduce a comprehensive new accounting model for insurance contracts, covering recognition, measurement, presentation and disclosures. IFRS 17 will lead to significant changes in accounting for insurance contracts. The mandatory effective date is 1 January 2021.

With the introduction of Solvency II in 2016, the PRA returns for 2016 are in a new format – the Solvency & Financial Condition Report 'SFCR'. Life companies used to be required to submit their regulatory returns with the form CT600 but this practice has been largely discontinued. Companies may be asked for a copy of their annual SFCR, which is public information, as part of any risk assessment process.

LAM01120: Long-term insurance business overview: commercial background to the tax regime

The tax and regulation for life companies have been subject to major changes, with the new life tax regime effective from 1 January 2013 and the new SII regime effective from 1 January 2016. Changes in tax, regulation and accounting can impact significantly on the mix and type of life products sold.

Regulation has in recent years driven significant changes to distribution models with the reward for insurance intermediaries moving from commission payments from insurers to fee based charges to customers.

Changes to the rules governing tax favoured pensions have had a dramatic impact on the market for annuity products and for pension products generally, which have been a significant part of the traditional life insurance market. In particular, the withdrawal of the requirement to purchase an annuity with the proceeds of a pension policy in 2015 severely impacted the market for pension annuities. Reductions in the amount of pension contributions that are tax deductible and the introduction of automatic enrolment of employees in pension schemes have impacted the shape of the pensions market.

Capital requirements are of critical importance for life companies given the long-term nature of the business and this influences product design and volume. Changes in the regulatory regime, such as the introduction of SII on 1 January 2016, often impact on commercial activity. SII, for example, meant that some products, such as annuities, required more capital than previously was the case making these less attractive products and contributing to the reduction in the number of participants in the market.

Capital requirements can also influence or drive corporate structure and intragroup transactions, such as reinsurance. Further comments on this aspect are included in the reinsurance chapter LAM10000 and the international chapter LAM12000. Regulation has also been a factor in driving consolidation in the sector, with life groups being taken over, and specialist life company 'consolidators' acquiring existing books of traditional life policies. As a result, there has been a steady flow of transfers of business between life companies which generate particular tax consequences. These are explained in LAM13000.

The new life tax regime is simpler than the previous regime, with less scope for outcomes that are not aligned with the underlying economic position. However, where the life company is chargeable to tax on I-E profits, the tax regime is still potentially complex. This is particularly the case where there is a range of products types and a wide range of types of investment vehicles.

Accordingly, to adequately risk assess a life insurance company writing BLAGAB an understanding is required of:

- The accounting, regulatory and commercial context – explained briefly above
- The interaction between tax on the company trade profits, the tax on 'policyholders' investment return' (also taxed in the company) and the taxation of the products in the policyholders' hands
- The taxation of investment vehicles generally. Life companies are major investors across a wide spectrum of investment types. The tax treatment of returns from investment vehicles is set out in the Savings and Investment Manual (SAIM). LAM03000 covers the position where special rules apply to investments made by life companies

LAM01130: Long-term insurance business overview: key concepts: a simplified overview: FA2012/S55

For tax purposes, a life company is carrying on a trade. The long-term business trade profits must be split into two separate businesses for tax purposes following FA2012/S66:

- relating to products where the investment return to policyholders is to be taxed under the I-E regime (BLAGAB) as a separate business
- all other profits (non-BLAGAB) taxed as a single trade

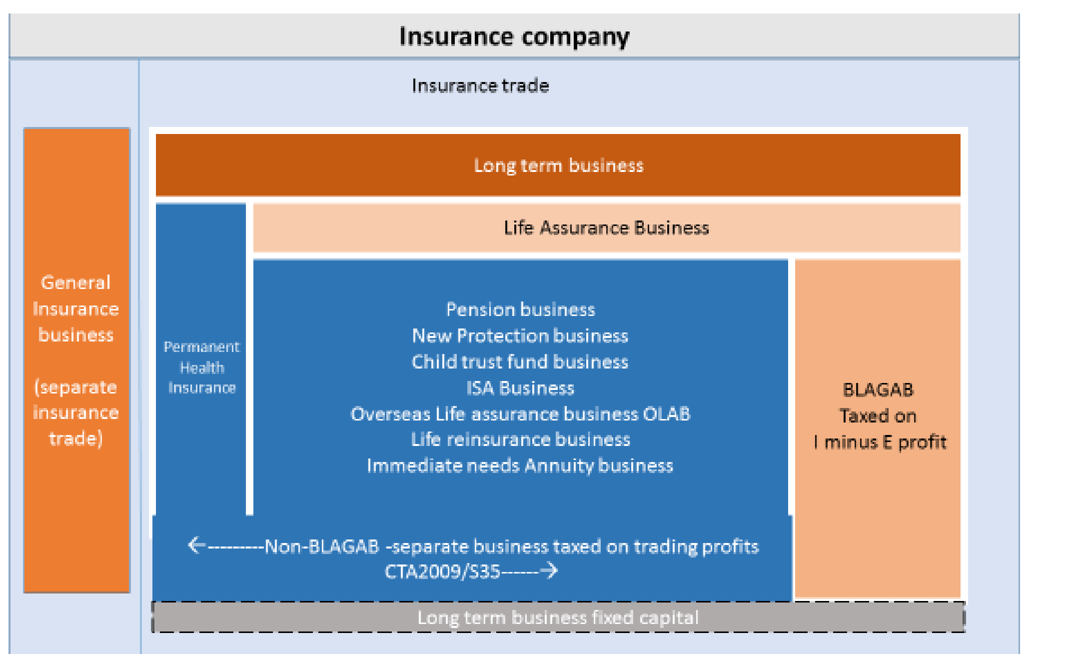
In addition, the company must determine which part of income, gains and expenses must be allocated to BLAGAB and brought into the I-E profit computation.

A life company may have 'Long-term Business Fixed Capital' (LTBFC) under the transition from the pre 2013 life tax regime or structural assets such as subsidiaries, which are not part of the trading activity. LAM11000.

A small number of life companies also write general insurance business with 'composite' licences. Such licences are no longer granted. In these cases the accounts usually separate

out the general insurance business so apportionments are not necessary. The general insurance or 'short-term' business will be a separate trade for tax purposes FA2012/S66.

The split of the life company into these elements can be illustrated as follows, with the definitions of the types of long-term business for tax purposes set out in LAM01140



Apportionments have to be made between BLAGAB and non-BLAGAB for both trading profit calculations and for calculation of BLAGAB investment income, gains and expenses. LAM05000

Given the regulatory prohibition on insurance companies engaging in any non-insurance related activities, any substantive activity outside the insurance trade, other than holding subsidiary companies, is unlikely- see PRA Rulebook Conditions Governing Business rule 9. This prohibition means that insurance groups will often set up separate service and/ or employment companies to ensure compliance with this rule. Regulatory restrictions may in some circumstances result in recharges at cost. This is further explained in LAM12200.

LAM01140: Long-term insurance business overview: key concepts: tax definitions of business categories: FA2012/S56-63

The key definitions required to split long-term business between BLAGAB and non-BLAGAB and other categories for tax purposes are derived from both regulation and tax legislation.

Long-term insurance business is a regulatory term defined in the FSMA 2000 (Regulated Activities) Order SI 2001/544 (PDF 182KB)

The table below lists the regulatory categories in Part II RAO and links these to tax definitions:

Part II RAO	Category for tax
I Life and annuity	Life assurance S56(2)(a)
II Marriage and birth	Life assurance S56(2)(a)
III Linked long-term	Life assurance S56(2)(a)
IV Permanent health	Long-term business S63(1)(b) – not LAB S56

V Tontines	Not LTIB
VI Capital redemption contracts	Life assurance but only as specifically defined in S56(3)
VII (a) Pension fund management contracts	Not LTIB
VII (b) pension fund management contracts combined with other features	Life assurance S56(2)(a)
VIII & IX Contracts referred to in articles 1(2)(e) and 1(3) of first life directive	Not LTIB

Tax definitions

FA2012/S56 defines life assurance business for the purposes of Part 2 of FA2012. It includes certain categories within the regulatory definition such as life, annuity and pension contracts linked to human life. It includes capital redemption business according to a specific tax definition S53(3). It does not include PHI as defined for regulatory purposes. PHI, which is often referred to as income protection, is included in the tax definition of long-term business in FA2012/S63 (and within the definition of non-BLAGAB in S66) along with life assurance business.

BLAGAB or basic life and general annuity business is defined in FA2012/S57 as all life assurance other than certain categories of business which are treated as non-BLAGAB. The table below lists the categories of long-term business which are taxed together as non-BLAGAB. The descriptions are for general guidance only – see legislation for more details.

Link to legislation FA2012 unless stated	Non-BLAGAB Simplified Description
S58 pension business	Contracts for the purposes of registered pension schemes and reinsurance of such business including pension annuity business.
S59 child trust fund business	A policy that is an investment under the Child Trust Funds Act 2004.
S60 ISA business investment savings account business	A policy that is an investment under the ITTOIA2005/S695(1).
S61 OLAB overseas life assurance business, SI 1995/3237	Contracts with policyholders not resident in the UK subject to specific conditions and exclusions.
S62 protection business	Policies (post 2012) where benefits cannot exceed premiums payable except on death or incapacity, for example, term assurance.
ITTOIA 2005/S725 immediate needs annuity	Policies to pay annuity where policyholder has incapacity at the time the contract is taken out.
S63 and s64 PHI permanent health insurance	Policies exceeding a 5 year period where benefits provide against the risk of incapacity or illness.
Reinsurance and excluded business S57(2), SI 2018/528	Reinsurance of life assurance business other than excluded business. LAM10000.

These categories of business are all taxed as a single non-BLAGAB trade (FA2012/S66(5) on a trading basis. Further details are included in LAM07000.

LAM01150: Key concepts: tax definitions of 'contract of insurance', 'contract of long-term insurance' and 'insurance company': FA2012/S64-65

FA2012/S64 links the definitions of a contract of insurance and a contract of long-term insurance to the regulatory definition in FSMA (Regulated Activities) Order 2001. Further details of the different categories are set out above in LAM01140.
FA2012/65 defines an 'insurance company'.

An insurance company covered by this definition will generally be regulated in the UK by the PRA or have a permanent establishment in the UK with 'passporting rights' into the UK from another EU or EEA regulated territory. The passporting position is dependent on the UK's status with the EU.

The clear link between tax and regulation means that it is generally straightforward to identify if there is an insurance company to which the life tax rules will apply.

Long-term business may be written by mutual insurers, which will fall with the definition of 'insurance company' and any BLAGAB written will fall within the I-E FA2012/S68 charging provisions with only the policyholder rate of tax applying to any I-E profits.

Long-term business can also be written by registered friendly societies. These are not insurance companies in statutory terms so are not subject to the full life company rules. Instead a modified version of the rules are applied as set out in Part 3 of Finance Act 2012 (FA2012/S150-179).These rules are not covered in this manual.

LAM01160: Long-term insurance business overview: key concepts: simplified example of the I-E calculation

The tax system is aiming to tax the company on both the shareholder profit and the policyholder investment return. The table below shows the components of the each of these elements.

	Company/ shareholder profit	Policyholder return	Total
Premium	P	(P)	nil
Investment return	I		I
Claims	(C)	C	nil
Expenses	(E)		(E)
Opening liabilities	OL	(OL)	nil
Closing liabilities	(CL)	CL	nil
Bonuses	(B)	B	nil
Total	Trade Profit	Policyholder net return	I-E

The Trade profit and the I-E are subject to corporation tax. The trade profit at the normal CT rate and the I-E profit at the 'policyholder rate' linked to the basic rate of income tax (FA2012/S102(3)). The policyholder will receive the net return with credit for basic rate tax and will be liable for any higher rate tax depending on their personal tax position.
In a simple case, for a (non-mutual) life company writing non-linked pension business (non-BLAGAB) and non-linked BLAGAB life business, the main components charged to tax can be summarised as:

1. Non-BLAGAB trade profits based on commercial apportionment of the accounting profit taxed at the normal CT rate.

2. I-E profits based on apportioned BLAGAB investment income plus BLAGAB chargeable gains less BLAGAB expenses.

- The I-E profit is then taxed at the normal CT rate (19% in 2018) up to the amount of the adjusted BLAGAB trade profits (apportioned using an acceptable commercial method).

- The balance of the I-E profit is taxed at the policyholder tax rate which is the basic rate of income tax (20% in 2018).

- This is subject to a 'minimum profits test'. If the sum of the I-E profit is less than the BLAGAB trading profit, then the I-E charge is increased up to the amount of the BLAGAB trading profit and is all charged at the normal CT rate. This adjustment is matched by an increase in expenses carried forward in the I-E computation.

This is a highly simplified explanation to illustrate the principles. It does not set out all the adjustments required – in particular in relation to BLAGAB trade profit calculations. These are explained in the relevant chapters.

A numeric example to demonstrate the principles is as follows:

10. total profits in 2018 were £1,000m
11. of these £600m were allocated to pension business (using commercial allocation)
12. investment income and gains less expenses allocated to BLAGAB were £1,250m. (Bear in mind that there is no direct link between the BLAGAB I-E result and the trading profit)

The highly **simplified** tax calculation would be as follows:

I-E profit	**£1250m**	**£'m**
Taxable at normal CT rate	400 @ 19%	76
Taxable at policyholder rate	850 @ 20%	170
Tax on I-E profit		246
Non-BLAGAB profits	600 @ 19%	114
Total tax charge		**£360m**

The I-E charge combines tax on the company trade profits with tax on the I-E investment return accruing to fund policyholder benefits. The £1,250m may include loan relationships gains, income from property and interest bearing securities and chargeable capital gains less related interest and management expenses and loan relationship deficits. In this case the first £400m of the I-E profit is taxed at the normal CT rate of 19%. The balance of £850m is taxed at the policyholder rate of 20%.

The minimum profits test (not shown in the example) aims to ensure that tax is always paid on company trade profits (in this case it would be based on the £400m), even if there is a loss attributable to policyholders. In the past the CT rate was higher than the policyholder rate and attributing more profit to trading profit would result in a higher tax charge. With CT rates below the basic rate of income tax this is no longer be the case.

The non-BLAGAB charge taxes the company on the profits it makes from pension business. The investment return on pension business is included in the non-BLAGAB trade profit calculations. In practice, this return is offset by liabilities to policyholders. Pension business is excluded from falling within the definition of BLAGAB (FA2012/S57(2)(a)) and is therefore not

subject to the I-E tax charge. The apportioned non-BLAGAB profit is taxed under CTA2009/S35 – FA2012/S71.

This is a highly simplified example for illustration only. There is no minimum profits test adjustment required, nor any other complicating factors such as BLAGAB losses or I-E excess expenses or other computational items such as double tax relief. A more detailed and realistic (although still simple) tax computation is set out in LAM08000 and cross references are made there to the relevant sections in the manual which explain the underlying basis.

The principal chapters covering the I-E charge are in LAM02000 (overview), LAM03000 (Calculation of Income 'I') and LAM04000 (Calculation of expenses 'E').

LAM01170: Long-term insurance business overview: background to introduction of the FA2012 life tax regime

The tax and regulation for life companies have been subject to major changes, with the current life tax regime effective from 1 January 2013 and the SII regime effective from 1 January 2016. Changes in tax, regulation and accounting can impact significantly on the mix and type of life products sold.

The new life tax regime is simpler than the previous regime, with less scope for the tax arbitrage which arose because of differences between the discretion afforded by the regulatory returns and the former mechanical tax rules.

The life tax legislation pre FA2012 referenced the annual regulatory returns. The 'surplus' arising in those returns was the starting point for trading based calculations of taxable profits. Tax legislation included specific references to form numbers in a return that has now been superseded by the new SII regulatory returns, the Solvency and Financial Condition Report 'SFCR'. The changes to the tax legislation were introduced in advance of the regulatory change to avoid a situation where the existing legislation would no longer function in the absence of the specified returns. At the same time the regime was simplified, removing some historical anomalies and aligning it to some extent more closely with the commercial position of the life companies and with the taxation basis of other types of companies.

The main conceptual changes introduced in FA2012 were:

- trading taxable profit is now based on accounting profit not regulatory surplus
- the I-E computation was simplified by limiting its scope solely to BLAGAB business (and at the same time excluding post 2012 'new' protection business from BLAGAB and taxing on a trading basis FA2012/S62)
- apportionment bases required to split the income and profits linked to the policyholder tax charge are based on the underlying commercial position of the company. Previously there was a rule based calculation based on a ratio of adjusted liabilities

The new regime was effective for accounting periods beginning on or after 1 January 2013 FA2012/148.

As a result of the change, transitional rules were required to ensure that profits and losses did not drop out of account or were taxed twice when moving from the regulatory surplus to the accounting profit.

The application of the transitional rules is summarised in LAM14000. The tax adjustments on transition have now largely been agreed. These adjustments, with a small number of

exceptions, will feature in tax computations over a ten year period ending in 2022 and therefore explanations of these are important to an understanding of the tax computation.

The changes introduce some ongoing adjustments in addition to the transitional tax adjustments and split of protection business referred to above. For example, the treatment of acquisition expenses pre and post 1 January 2013. These have different tax and accounting definition and treatment pre 2013 but are aligned with accounts post 1 January 2013. This is explained further in LAM14000.

LAM01180: Life insurance overview: abbreviations

The most common abbreviations are listed below:

BLAGAB	Basic life assurance and general annuity business
CTA	Corporation Tax Act 2009
CTFB	Child Trust Fund Business
EEA	European Economic Area
EU/EC	European Union / European Community
FCA	Financial Conduct Authority
FSMA	Financial Services and Markets Act 2000
ICTA (1988)	Income & Corporation Taxes Act 1988
INSPRU	Prudential Sourcebook for Insurers
Life assurance/ insurance	Interchangeable commercial description See also tax definition
PHI	Permanent health insurance business
PRA	Prudential Regulation Authority
RAO	FSMA 2000 (Regulated Activities) Order SI 2001/544 (PDF 192KB)
SII	Solvency II
ICOBS	FCA Insurance conduct of business sourcebook

Further definitions are available on the regulators websites and in Chapter 2 of FA2012/S136–141.

LAM02000: I-E overview

LAM02010 I-E overview: background and policy objective

LAM02020 I-E basis: computation overview

LAM02030 Landscape of the legislation in FA2012 Part 2

LAM02040 Charge to Tax on I-E basis: separate businesses/trades: FA2012/S66-67

LAM02050 Charge to tax on I-E profit: FA2012/S68-72

LAM02060 Calculating I-E Profit: the 6 steps in FA2012/S73

LAM02010: I-E overview: background and policy objective

Insurance companies writing long-term business falling within the definition of BLAGAB must consider the application of the life tax I-E provisions in Part 2 of FA2012.

The current position for taxing life companies has evolved over many years. The policy objective is to collect tax from the life company on the investment return accruing for the benefit of policyholders on BLAGAB policies. This is as a proxy for the policyholder paying tax at the basic rate of income tax. When the policyholder receives benefits under the policy, any taxable profits arising are taxed after giving credit for the basic rate of income tax. For a basic rate taxpayer, therefore, there is no further tax liability.

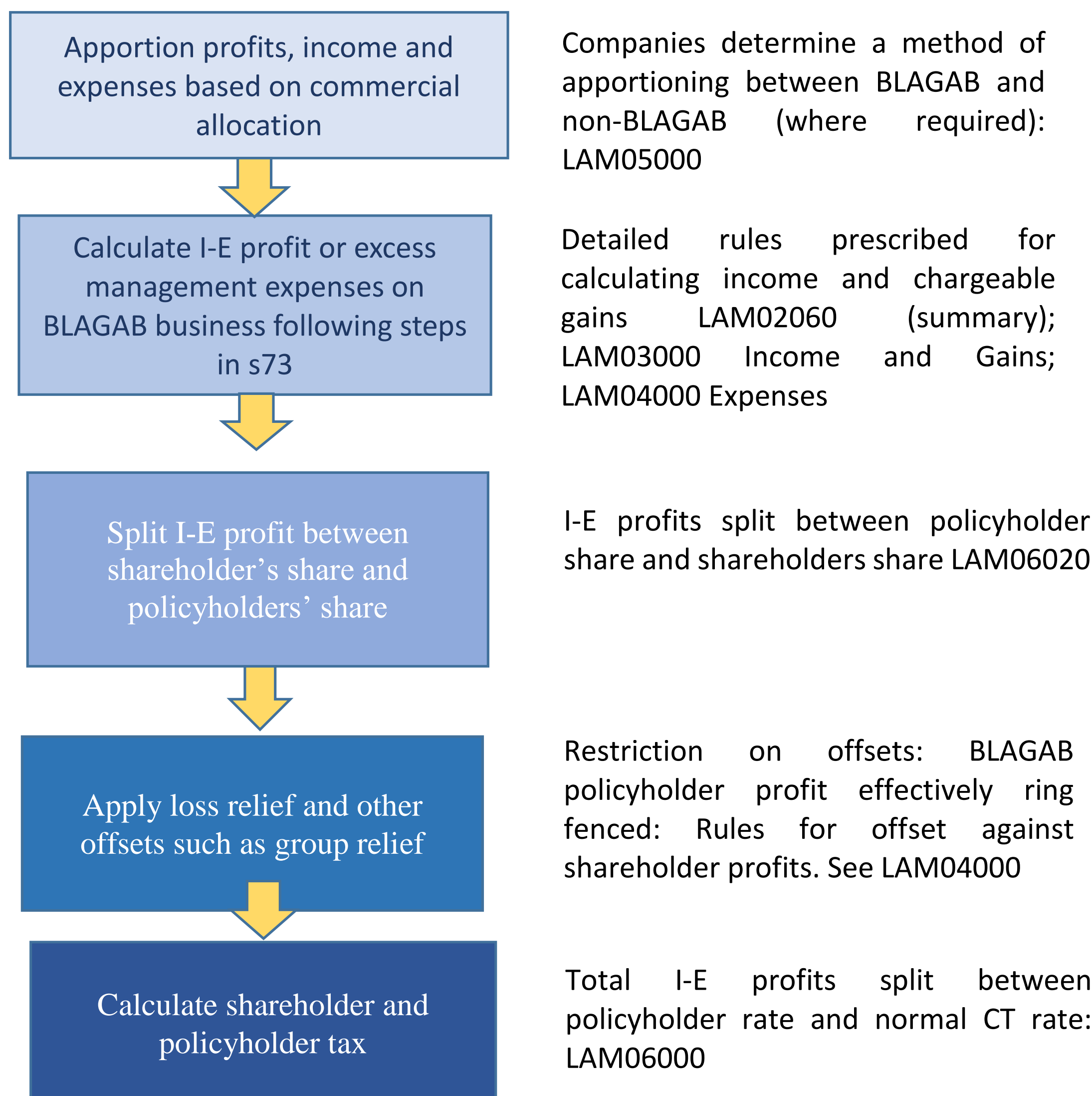
At the same time, the company must also pay tax at the CT rate on the company profits, on the same basis as other entities.

There is an overlap and interaction between the two tax objectives in trying to encompass these in one tax computation. This is one reason why a life tax computation involving BLAGAB may appear to be complex. LAM01160 has further explanations of the principles underlying the policyholder and company positions and the elements involved in the calculations.

Further information on the background to the introduction of the current life tax regime is set out in Long-term business overview LAM01000. Familiarisation with the commercial, accounting and regulatory background set out in LAM01090 onwards is important in understanding the context for the I-E charge on profits.

LAM02020: I-E overview: computation overview

This section provides an overview of the main building blocks of the I-E profit computation:



The policy holders' share of BLAGAB I-E profit is substantially, but not completely, ring-fenced from the other profits of the company. The main drivers of I-E profit are generally loan relationships and chargeable gains (dividends being exempt). Life companies have large bond portfolios taxed on a mark to market basis. Fluctuations in market value can result in significant variations in I-E profits or produce excess management expenses. Capital gains (on property, shares and other investments) are also important and again can fluctuate depending on both market movements and realisations.

- The calculation of BLAGAB I-E profit is summarised in LAM02060 and explained further in LAM03000 and LAM04000
- LAM05000 explains how income and gains are allocated to BLAGAB for I-E calculations and apportioned between BLAGAB and non-BLAGAB for trade profits calculations
- Other taxable profits broadly comprise almost everything else in the life company that is not included in BLAGAB. These will include:

- non-BLAGAB trade profits taxed as a single trade. See LAM07020 and LAM05000 for apportionment rule

- general insurance trade profits taxed as a separate trade (in a limited number of circumstances): normal rules apply see General insurance manual

- non-trade profits: normal corporation tax principles apply: these could include profits derived from LTBFC as described in LAM08000

- Deductions against total profits will be principally loss relief and group relief. A summary of the loss and expense offset rules is included in the tax computation chapter at LAM08000
- The rules for the split of taxable profits between those taxed at the policyholder rates and those taxed as the normal CT rates are set out in LAM06000

The main components of a life insurance company tax computation are illustrated in the diagram in LAM08020 and this includes cross references to the relevant parts of this manual.

LAM02030: Landscape of the legislation in Part 2 FA2012: insurance companies carrying on long-term business

This section lists the chapters in Part 2 FA2012 ‘Insurance companies carrying on long-term business’ and cross refers to the relevant principal section in this manual.

Chapter/	Section	Description	LAM reference
1	55-65	Outlines structure of Part 2 and defines key terms including categories of business	01140 01150
2	66-72	Charge to Tax on I-E basis: the basic charging provisions	02040 02050
3	73-96	The I-E basis: rules for determining the amount of profit or loss	03000 04000
4	97-101	Apportionment rules I-E – allocation to BLAGAB and non-BLAGAB	05000
5	102-108	Policyholder’s rate of tax: determines shareholder - policyholder split of I-E profit and applies equivalent to basic rate of income tax to policyholder share.	06000
6	109-113	Trade profits: general trading profit rules for BLAGAB and non-BLAGAB long-term business	07000
7	114-115	Trading apportionment rules; .allocates accounting profits, losses and various adjustments between BLAGAB and non-BLAGAB long-term business	05000
8	116-122	Long-term business assets: rules for capital gains on transfers between categories of business, intragroup and share pooling rules	03000
9	123-127	Relief for BLAGAB trade losses	07130
10	128-135	Transfers of long-term business	11000

11	136-141	Definitions: definitions, abbreviations and index of defined terms	various
12	142-149	Supplementary: commencement date, transitional provisions and powers conferred on HM Treasury to amend legislation by way of secondary legislation or by exercise of powers under the Financial Services and Market Act 2000.	various

Part 3 of FA2012 relating to Friendly Societies is not covered in this manual.

There is other life assurance specific legislation outside of FA2012, for example, in TCGA1992. These provisions are not listed here but referred to in the relevant chapters, starting in Chapter 3 LAM03000.

LAM02040: Charge to Tax on I-E basis: separate businesses/trades: FA2012/S66-67

Where an insurer writes regulated long-term insurance business through a place of business in the UK, the company profits will be trade profits and the special rules in Part 2 FA2012 will apply.

FA2012/S66 introduces the concept of separate businesses, where a company writes both BLAGAB and non-BLAGAB long-term business.

BLAGAB

BLAGAB is a separate business to which the I-E basis applies. The I-E basis has some similarities with the treatment of an investment company, where the profit in the accounts is not the primary starting point for taxable profits. However, the company long-term business activities are all essentially trading and there is still a trading profit calculation undertaken. This is only used for specific purposes with the I-E framework, such as the minimum profits test and calculation of the shareholders share of profit. Trade profits are also relevant for rules such as offset of losses and group relief.

Non-BLAGAB

All non-BLAGAB long-term business is regarded as a single trade. It will be the only trade if the company does not carry on any BLAGAB business or general insurance business. So, for example, a company writing only unit-linked pension business will have a single non-BLAGAB trade. The charge to corporation tax will be under CTA/S35 as for companies generally. It is only where there is a mix of business that includes BLAGAB that the additional I-E rules have to be considered

The general rules are modified as noted in FA2012/S71 and chapter 6 to include rules relating to trade profit calculations, trade profit apportionments and transfers of business. The result is likely to be substantially the same as a normal financial trading company computation (e.g. dividends are taxable) LAM07000.

‘Substantially all’ non-BLAGAB

There is an exception to the general rule providing for a separate BLAGAB business in in FA2012/S67 where ‘substantially all’ of a company’s long-term business is non-BLAGAB.

The policy objective is to minimise the compliance burden of producing BLAGAB tax computations for small amounts of BLAGAB business with small amounts of tax at stake.

There is no set limit for defining 'substantially all'. The application of this provision will depend on the facts and circumstances in each case. As a general rule, S67 should be applied where the amounts of business are small in absolute terms. This could be measured in terms of liabilities or investment income and gains potentially accruing. The amounts of tax at stake over the life of the policies should be considered before applying S67.

Companies only writing PHI business FA2012/S72

Companies only writing PHI business (which is long-term business but not life assurance business) are excluded from all application of special long-term business rules.

Such rules may still apply in relation to PHI business written within companies not wholly writing PHI. For example, FA2012/S111 which brings dividends specifically into the trading computation will apply to dividends allocated to PHI business in the same way as for other long-term business assets. However, companies are able to take a deduction under CTA2009/S400 on index-linked gilts for the index linking on gilts backing their PHI business. For assets backing other long-term business this deduction is removed by FA2012/S112 but PHI is carved out of S112.

Protection business

Companies writing only long-term protection business as defined in FA2012/S62 (business post December 31st 2012) are not subject to the I-E charge as such business is excluded from the definition of BLAGAB in S57. Where business is written after 31st December 2012 and the company has elected under the transitional provisions to have pre 2013 business taxed as 'new' protection then there will be no BLAGAB I-E charge. LAM14040

Reinsurance business

Life reinsurance business is subject to special rules. See LAM03060-03080

Non-insurance activity

Regulation generally prohibits insurance companies from carrying on any non-insurance activities. In addition, the regulator no longer grants composite licences to write general and long-term business in a single company and few of these now remain active. Therefore, life companies are most likely only to have trading activity comprising BLAGAB and/or non-BLAGAB business. In some cases there may be some reinsurance business.

LAM02050: Charge to tax on I-E profit: FA2012/S68-72

The charging provisions in FA2012/S68 apply to the BLAGAB 'I-E profit'. FA2012/S69 excludes BLAGAB income and gains from any other charge to corporation tax, including under CTA2009/S35.

The calculation of the I-E profit and any excess BLAGAB expenses is then set out in the subsequent sections which are described in FA2012/S70(2) as 'the I-E rules'. This charge includes provision which combine the charge to tax on the policyholders profits derived from the investment return and shareholder trade profits on the BLAGAB business.

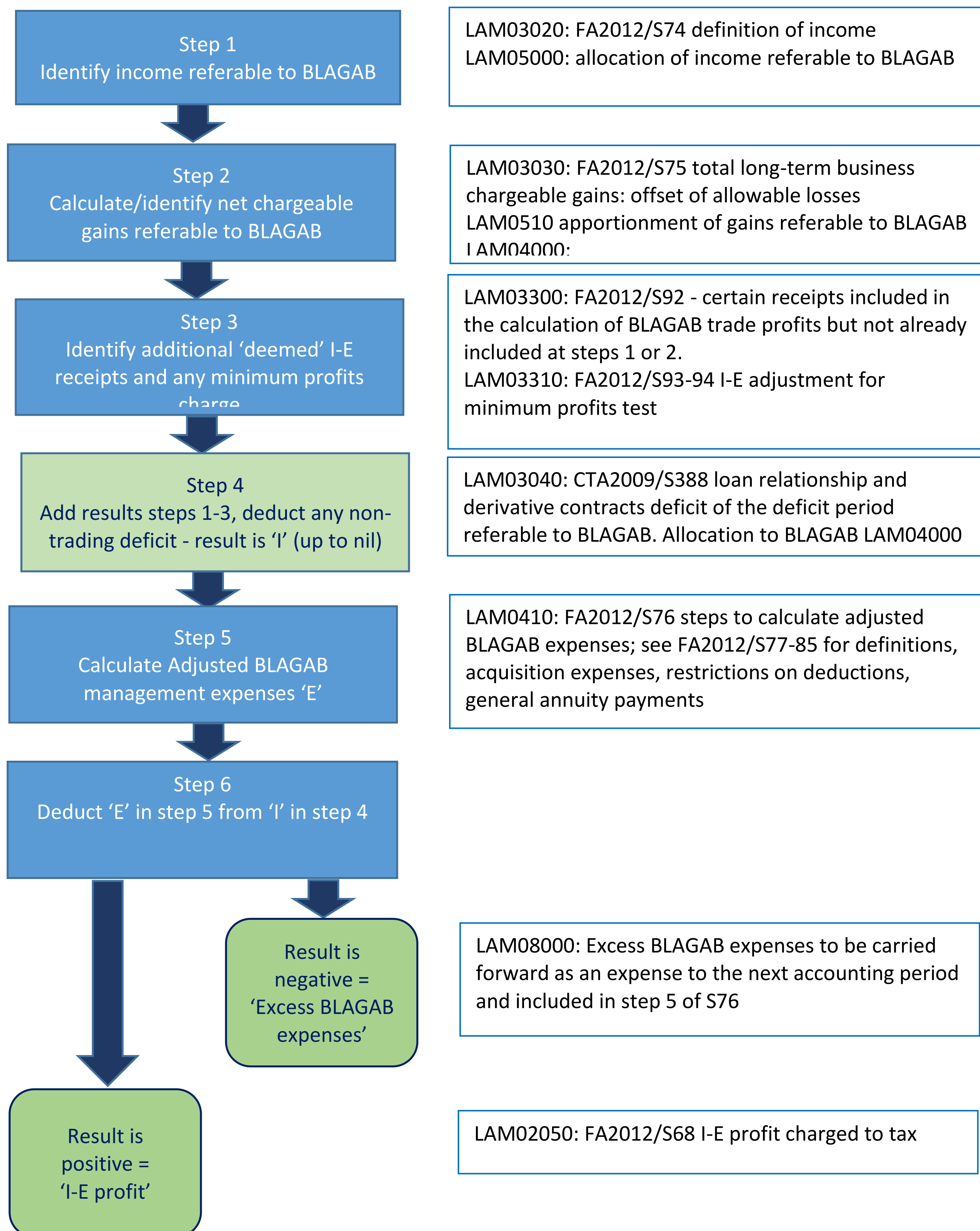
Mutual Companies

Mutual companies' long-term business trade profits will not be subject to corporation tax under normal principles and explicit reference is made to this in FA2012/S71(3).

Mutual life insurance companies will be subject to tax on any I-E profit arising under the I-E rules at the policyholder rate as this reflects the policyholder return. FA2012/S103(2) provides that all of the I-E profit will belong to the policyholders because there are no shareholders.

LAM02060: Calculating I-E Profit: the 6 steps in FA2012/S73

The charge to corporation tax applies to the I-E profit of the basic life assurance and general annuity business of an insurance company FA2012/S68(1). FA2012/S73 provides the mechanism to determine the amount of profit or expense for a given accounting period, referred to as the "I-E profit" or "excess BLAGAB expenses". The calculation involves 6 steps. These are summarised below with cross references to the relevant sections for more detail.



LAM03000: I-E - Calculation of 'I' Income and Chargeable Gains

LAM03010 Income and gains within 'I': Overview of tax basis

LAM03020 Steps 1 and 2 - Computing 'I'- overview and identification of assets: FA2012/S74-75

LAM03030 Step 1 What is included as income: FA2012/S74

LAM03040 Main sources of BLAGAB investment return - summarised tax treatment

LAM03050 Other potential sources of income and gains 'I': intra-life company and intragroup transfers and SSE

LAM03060 Loan relationships, derivative contracts and intangible fixed assets: non trading treatment of credits and deficits: FA2012/S74(1): FA2012/S88 : CTA2009/S388-391

LAM03070 Derivatives not treated as Loan relationships CTA2009/Part 7: FA2012/S74(1)(a)

LAM03080 Land and Property- Separate property business and losses from property business (s74(1)(a))

LAM03090 Miscellaneous income and losses FA2012/S74(j):FA2012/S89

LAM03100 Stock lending and Repos: TCGA1992/263B-C, CTA2009/S546

Step 2 Chargeable Gains and allowable losses main provisions

LAM03200 Step 2 FA2012/S73 Calculating BLAGAB chargeable gains - an overview: FA2012/S75

LAM03210 Box Transfers: FA2012/S116

LAM03220 Life companies as capital gains group member

LAM03230 Transactions in shares: share pooling rules: FA2012/S119-121

LAM03300 Collective investment schemes - annual deemed disposal: overview:TCGA1992/S212

LAM03310 Collective investment schemes annual deemed disposal – categories of funds: TCGA1992/S212

LAM03320 Collective investment schemes not subject to TCGA1992/S212

LAM03330 Spreading of deemed disposal gains: TCGA1992/S212

LAM03340 Deemed disposal loss offset and carry back: TCGA1992/S213(3)

LAM03350 Deemed disposals: cessation/transfer of business; seeding an Authorised contractual scheme: losses on disposal to connected 'authorised fund manager'

LAM03400 Step 2: Allowable Capital Losses FA2012/S75: Non-BLAGAB allowable losses FA2012/S95;TCGA1992/210A

LAM03410 Step 2: Calculating the shareholder’s share of BLAGAB gains S210A(2)

LAM03420 Step 2: Calculating the shareholder’s share of BLAGAB losses S210A(6)-(9)

LAM03430 Unrelieved General Annuity Business (GAB) Losses

Steps 3 and 4

LAM03500 Step 3 FA2012/S73 Calculate deemed ‘I-E’ receipts

LAM03510 Step 3 – Calculating ‘I': FA2012/S93 minimum profits test and s94 adjustment - main treatment in LAM07170

LAM03520 Step 4 – Calculating ‘I’: CTA2009/S388 deduction for non-trading deficits - main treatment in LAM03070

Step 2 Chargeable gains and losses – further provisions

LAM03600 Chargeable Gains From Venture Capital Limited Partnerships TCGA1992/Sch7AD:overview

LAM03610 Chargeable gains from Venture Capital Limited Partnerships TCGA1992/Sch7AD: Acquisition cost of the deemed single asset

LAM03620 Chargeable gains from Venture Capital Limited Partnerships TCGA1992/Sch7AD: Disposals

LAM03630 Chargeable gains from Venture Capital Limited Partnerships TCGA1992/Sch7AD: Deemed disposals: computational rules for part-disposals

LAM03640 Chargeable gains from Venture Capital Limited Partnerships TCGA1992/Sch7AD: Scope and Conditions of Schedule

LAM03650 Chargeable gains from Venture Capital Limited Partnerships TCGA1992/Sch7AD: Interaction with other legislation

LAM03700 Transactions in shares: share exchanges (where SSE does not apply)

LAM03710 Transactions in shares: Bed & Breakfasting TCGA1992/210B

LAM03720 Transactions in shares: “substantial shareholdings” "SSE" TCGA1992/Sch7AC

LAM03730 Substantial shareholdings exemption, ”SSE” The interaction of the SSE rules and other life tax rules

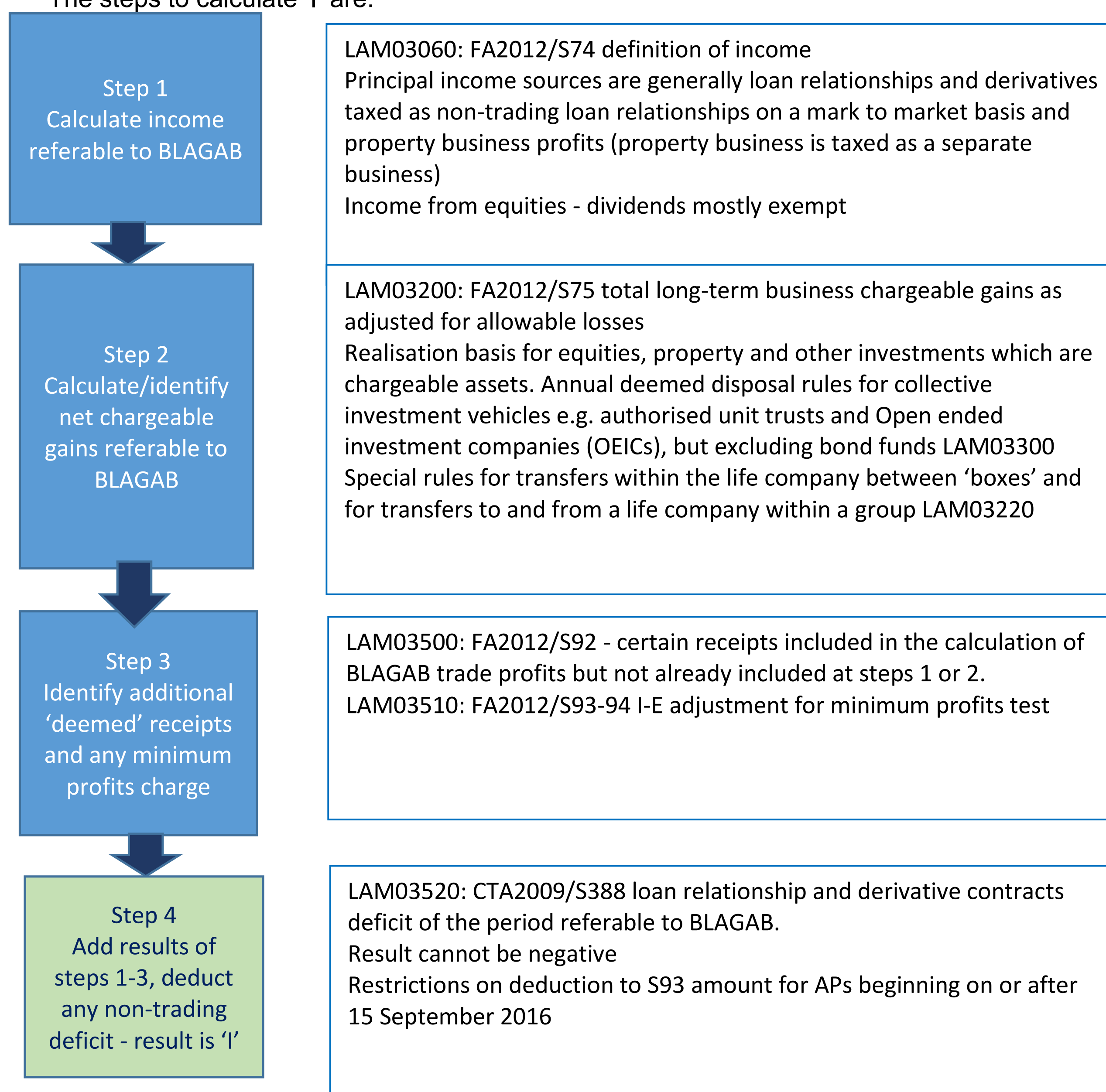
LAM03740 Substantial shareholdings exemption, “SSE” and Gains on Loan Relationships and Derivative Contracts

LAM03010: Income and gains within 'I': Overview of tax basis

The income and chargeable gains of a life company referable to BLAGAB are charged to tax as part of the 'I-E' profit in S68 and are calculated in accordance with steps 1 to 4 in FA2012/S73. This chapter explains the tax treatment of the main sources of investment return within a life company as part of that calculation.

Life insurance companies typically have extensive investment portfolios and may have a number of internal fund structures such as with-profits funds all of which can add to the complexity of computing 'I'. Life insurers may hold equities, bonds, derivatives, property etc. These investments can be held directly or via an investment vehicle such as a unit trust, Open Ended Investment Company (OEIC), partnership or other structure appropriate for holding the relevant assets. Analysis of the portfolio requires a detailed review of the portfolio assets and their respective tax treatment.

The steps to calculate 'I' are:



The tax basis of BLAGAB income and gains is more aligned with the treatment of investment companies with adaptations and differs significantly from the trading basis for non-BLAGAB income and gains. Contrast mark to market taxation of non-BLAGAB investment gains with BLAGAB chargeable gains taxed on a realisation basis and deemed disposal rules for certain collectives. Dividend taxation in non-BLAGAB is another significant difference.

The differences can also impact, for example, on the tax treatment of movements of assets within life companies (see, for example, 'box transfers' LAM03210) and within groups containing a life company.

There are also special provisions for reinsurance of BLAGAB business. These are explained in LAM10000.

LAM03020: Steps 1 and 2- Computing 'I'- overview and identification of assets: FA2012/S74-75

Computing the 'I' in steps 1 and 2 in S74 and S75 requires analysis of the company's assets and the related income and gains to identify:

1. Assets in the life company where the return is within scope of the I-E charge i.e. the assets are backing BLAGAB business in whole or in part LAM03040. Where assets are only partly backing BLAGAB business the apportionment and commercial allocation rules in FA2012/Chapter 4 will apply LAM05000

2. Which of the chargeable gains 'boxes' (FA2012/S116) apply to the relevant assets- LAM03210

3. The type of assets identified in 1 above (bonds, unit trusts etc.) and assign the appropriate tax treatment to any income and gains arising (subject to any appropriate apportionment) LAM03040 and LAM03200

4. Any internal transfers within the company between 'boxes' and transfers within the group to or from the life company and assign the appropriate tax treatment LAM03210 and LAM03220. Internal transfers between boxes within a life company can trigger a tax charge and therefore the tax treatment of intragroup transfers can differ significantly for life companies from the position for non-life companies

This will enable the amounts in Steps 1 and 2 to be computed. Step 3 is then a separate step which brings into the calculation of 'I' any deemed receipts not included in steps 1 and 2 plus any minimum profits charge LAM07170. The tax computation in LAM08000 provides an example of how this might work in practice.

Consideration must also be given to general corporation tax provisions that may apply. For example, the CFC legislation LAM12010 may apply to some of the assets of a life company. As life companies may hold substantial interests in offshore entities, particularly where they are also acting as the investment manager, a full analysis of offshore companies for compliance with the CFC rules is essential. There are rules which specify the circumstances in which a CFC charge will not be applied on assets within the BLAGAB I-E charge to avoid double taxation. (SI 2012/3044: The Insurance Companies and CFCs (Avoidance of Double Charge) Regulations 2012 LAM12010). Where a CFC charge does apply, it will not fall within the I-E computation.

Once the portfolio has been analysed, the normal capital gains tax provisions supplemented by the specific I-E rules will apply to the chargeable assets subject to capital gains treatment.

Any non-BLAGAB or other assets such as Long-term business fixed capital will not be part of the I-E calculation.

There may also in some cases be structural assets which are not part of the trade – such as holdings in subsidiaries – which would also have different treatment – see LAM10000.
Note that reinsurance of BLAGAB business can require adjustments to be made in the tax computation. See LAM10000.

LAM03030: Step 1 What is included as income: FA2012/S74

I-E taxation involves taxing the company on its investment return less expenses.

'Income' is defined for the purposes of the I-E calculation in FA 2012/S74.

'Income' includes the income or credits in the table below in so far as they arise from the company's long-term business referable to BLAGAB. These are income or credits that, but for inclusion in the I-E profit in FA2012/S68 (and exclusion from S35 charge FA2012/S69), would have been brought into account or chargeable under that provision ((FA2012/S74(5)) However, income arising from an asset forming part of the long-term business fixed capital (LAM10000) of the company is excluded as these are not regarded as part of the BLAGAB business (FA2012/S74(6)).

A significant proportion of taxable income will often come from loan relationships and to a lesser extent from income from land.

INVESTMENT RETURN	TAX TREATMENT
Rents and other receipts relating to land. S74(1)(a) UK and overseas Land and Property Income	Income from a UK or overseas property business chargeable under CTA2009/Part4/Chapter 3 less expenses (including capital allowances). Includes income chargeable in respect of distributions treated by CTA2010/S548(5) as profits of a UK property business. FA2012/S86 modifies the Property income rules in CTA2009/Part4/Chapter 3 to allow the application of I-E rules and provides for a life insurance company to have more than one property business. See LAM03180
Interest, profit on sales of debt asset, profits on derivative contracts. S74(1)(b) Loan relationship credits S74(1)(c) Credits in respect of derivative contracts	Loan relationships credits under CTA2009/ Part 5 and Derivative contract credits under CTA2009/ Part 7 as applied and modified by FA2012/S88. S88 ensures that for the purposes of the I-E calculation the loan relationship rules apply **as though the BLAGAB business were not a trade**. S88 further provides that only a net BLAGAB credit should be taken into account as income S88 (4) includes credits in respect of derivative contracts together with loan relationships for the purposes of I-E income. Deficits on loan relationships and derivative contract debits (Step 4 reduction) are dealt with at FA2012/S73 and discussed in LAM03060

Other types of income that are less common but also included in the S74 definition are as follows:

Royalties and gains on intangible fixed assets. S74(1)(d) Intangible fixed asset credits	Credits brought into account under CTA2009/ Part 8 as modified by FA2012/S88. S88 ensures that for the purposes of I-E calculations the intangible fixed asset rules apply as though the BLAGAB business were not a trade. S88 further provides that only a net BLAGAB credit should be taken into account as income. For intangible fixed asset debits see LAM03060
Dividends or other distributions S74(1)(e) Taxable Distributions	Any dividend or other distribution chargeable under CTA 2009/ Part 9A – Company Distributions.
S74(1)(g) Sale of foreign dividend coupons	Income chargeable under CTA2009/Part10/ Chapter 6.
Unfranked distributions S74(1)(h) Annual payments not otherwise charged	Unfranked distributions from authorised unit trusts and OEICs chargeable under CTA2009/Part10/Chapter 7
S74(1)(i) Overseas income not otherwise charged	Income arising from a source outside the UK which is chargeable under CTA2009/Part10/ Chapter 8
S74(1)(j) Miscellaneous income	Income chargeable under any provision to which CTA 2010/S1173 miscellaneous charges applies other than CTA2009/S752 (non-trading gains on intangible fixed assets)03100
S74(1)(k) Distributions from Unauthorised Unit Trusts	Income chargeable under regulation 15 of the Unauthorised Unit Trusts (Tax) Regulations 2013.

Distributions arising from equities, unit trusts and OEICs are the other significant sources of income but, with some limited exceptions, these distributions are not taxable income in the BLAGAB I-E computation.

In practice, it will be necessary to analyse all sources of income and decide which category applies, to ensure the correct treatment. In most cases this will be straightforward but, as life companies have extensive investment portfolios and regular turnover of investments, there can be many sources of income to consider within the rules. Income (other than premium income and amounts received under reinsurance contracts) that is not covered in the other provisions above or in the chargeable gains section should be considered as to whether it is taxable under FA2012/S92 or as miscellaneous income under FA2012/S74(1)(j).

LAM03040: Main sources of BLAGAB investment return – summarised tax treatment

The table below summarises the main sources of investment return which would be expected in a life insurance company, briefly refers to the basic BLAGAB tax treatment and links to the relevant part of this manual for further detail on the appropriate tax treatment for income and gains arising.

Simplified summary of main sources of BLAGAB income and gains		
Source of investment return	**Step 1 Income**	**Step 2 Chargeable Gains**
Debt securities and derivatives, intangible assets LAM03060	Loan relationships (CTA2009/Part5) and Derivative credits (CTA2009/Part7) taxed and	Certain derivatives are subject to CGT rules, excluded from LR treatment due to underlying

Simplified summary of main sources of BLAGAB income and gains		
Source of investment return	**Step 1 Income**	**Step 2 Chargeable Gains**
	accounted for on a mark to market basis. Intangibles (CTA2009/Part8). Rules applied as if BLAGAB is not trading or property business (FA2012/S88)	assets or specific anti-avoidance provisions (LAM3070)
Equities: LAM03200 Distributions, disposals derivatives CFM55000	Distributions exempt if they fall within an exempt category in CTA2009/Part 9A	Disposals dealt with under the CGT regime and thus on a realisation basis Derivatives broadly follow treatment of underlying equities
Land & Property: LAM03080 Rent /other receipts Derivatives.	Separate property business taxed on profits FA2012/S86	Disposals dealt with under the CGT regime on a realisation basis Derivatives follow treatment of underlying asset
Collective investment schemes and similar investments	See table below – collective investment schemes may take various forms	
Authorised unit trusts (AUTs) and Open ended investment companies (OEICs) LAM03300	AUTs and OEICs usually make dividend distributions which are subject to corporate streaming (regulations 48-51 SI 2006/964). An AUT or OEIC which is a bond fund may choose to make an interest distribution (also see below)	Annual deemed disposal at market value with gains spread over 7 years TCGA1992/S212. Special rules for losses. Derivatives follow treatment of underlying asset
Bond funds - Unit trusts, OEICs and offshore funds	If one of these funds meets the qualifying investments test, units held by a corporate are treated as rights under a creditor relationship and a distribution is treated as a loan relationship credit (or debit) – see CTA09/Part 6/chapter 3	As for AUTs and OEICs
Authorised contractual schemes (ACS) LAM03250	Transparent – investors taxed on their share of underlying income as it arises.	Co-ownership fund ACS - holding treated as asset for capital gains. TCGA1992/S212 annual deemed disposal. Losses- special rules. Partnership ACS– transparent investor taxed on underlying share of capital gains
Offshore reporting funds	Income is the reportable income of the fund.	As for AUTs and OEICs
Offshore non-reporting funds other than partnerships	Opaque fund: income is amount distributed (or treated as distributed) by the fund.	Opaque fund: As for AUTs and OEICs. NB. gain is an offshore income gain.

Simplified summary of main sources of BLAGAB income and gains		
Source of investment return	**Step 1 Income**	**Step 2 Chargeable Gains**
	Transparent fund: Income is underlying income of the fund	Transparent fund: As for AUTs and OEICs. Not an offshore income gain, provided fund has no significant investments in other non-reporting fund and has made sufficient tax (primarily income) information available to investor.
Real estate investment trusts (REITs)	Property income distributions are taxed as income from property CTA2010/S548(5) Other distributions are taxed as per equities above	TCGA1992/S212 annual deemed disposal. Special rules for losses
Investment trusts	Interest distributions (loan relationship credits) or equity distributions (taxed as other equity holdings)	Disposals taxed on a realisation basis as for other equity holdings
Exempt unauthorised unit trust (EUUT)	Income is the amount shown in EUUT's accounts as available for payment to investor or for re-investment in the fund.	N/A –certain life companies that qualify as eligible investors can invest in EUUTs and the Trustees of the fund will continue to benefit from the exemption from tax on chargeable gains.'
Non-exempt unauthorised unit trusts (NEUUT)	NEUUT taxed as if it is a company and units are shares. Normal rules for distributions from companies apply.	Normal CG rules apply on disposal of an interest in a NEUUT.
Partnerships, including offshore	Normally transparent – taxed on underlying share of income	Taxed on share of disposals of underlying assets
Venture capital partnerships	Normally transparent – taxed on underlying share of income	Schedule 7AD applies to modify partnership rules for 'limited partners' - simplification
Other		
Stock lending CFM74100 and Repos CFM46200	Stock lending fees taxed as income. Manufactured payments dependant on underlying securities. Repos per CTA2009/Part 6/Chapter 10	

The above list is not exhaustive. It highlights the main types of vehicle/investment return that may be involved and the BLAGAB tax treatment. The portfolio mix can vary significantly between different groups and companies. Loan relationships, equities and collective investment vehicles tend to be the largest part of portfolios. Property holdings vary but tend to be a smaller proportion but still material in many cases and may be held within investment vehicles.

LAM03050: Other potential sources of income and gains 'I': intra-life company and intragroup transfers, SSE

The table below summarises some of the other features of the I-E system that require special attention as they can generate income or gains on transfers intra-company or different results from non-life companies on transfers between group companies and on external disposals of subsidiaries.

Other potential sources of income and gains	
Transfers of chargeable assets within a life company	Special rules apply which can trigger chargeable gains in situations where assets do not transfer out of the life company – LAM03210
Transfers of chargeable assets to or from a life company within a group	The intragroup transfer rules are modified for life companies – LAM03220
Disposals of subsidiaries or associates	The Substantial shareholdings exemption 'SSE' is modified for life companies – LAM03730

The life company specific rules for computing BLAGAB income are summarised in LAM03030 and for BLAGAB capital gains rules in LAM03200

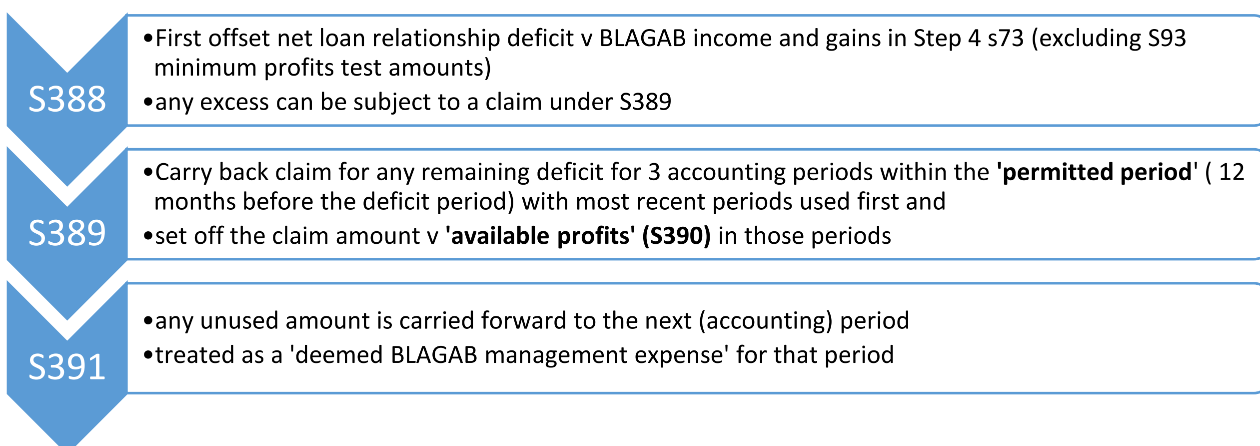
LAM03060: Loan relationships, derivative contracts and intangible fixed assets: non trading treatment of credits and deficits: FA2012/S74(1): FA2012/S88 : CTA2009/S388-391

The rules in S88(2) stipulate that deficits or credits relating to loan relationships and derivatives and gains and losses relating to intangibles (under CTA2009/ Part 8) that are referable to BLAGAB are treated as not relating to a trade or a property business. The main practical consequence of this is that the rules for offsetting non-trading deficits, as described below, are more restrictive than for trading deficits.

In the I-E calculation only the net debit or credit is brought into account- S88(3).

BLAGAB loan relationship deficits (including derivatives deficits) are therefore non-trading deficits. Any deficit must first be offset against other BLAGAB income and gains in the deficit period at step 4 of S73, before the deduction of BLAGAB management expenses. (CTA2009/S388). For this purpose, BLAGAB income and gains available for offset excludes any minimum profits amount under FA2012/S93 – CTA/S389((2A) effective for accounting periods beginning on or after 16 September 2016.

CTA2009/S389-91 sets out the rules for utilisation of any deficits that can't be relieved against income and gains in step 4 of S73, these are illustrated below:



Example 1

Example – CTA2009/S390 ‘available profits’ for a carry back claim

Company A writes only BLAGAB. In 2017 A has income and gains from Steps 1-3 of S73 of £300m and net losses on its bond portfolio totalling £750m. This leaves £450m of net deficit unrelieved and available for carry back under S389. The company has a calendar year end and therefore the ‘permitted period’ is year ended December 2016.

In 2016 Company A has total ‘I’ of £800m, which includes £500m of net loan relationship credits, and adjusted BLAGAB management expenses of £400m.

Company A 2016 Available profits S390	£’m	£’m	£’m
BLAGAB non-trading loan relationships profits in permitted period (2016) potentially available to offset excess deficits from 2017			500
S390(5) Less unused part of relevant deductions for the permitted period (2016):			
Step 1: Add Adjusted BLAGAB management expenses for period S73		400	
Step 2: Add Amount of adjusted BLAGAB management expenses that could be deducted at Step 6 S73 to reduce to zero if there were no loan relationship profits	300		
		(300)	
Step 3: Deduct amount in Step 2 from amount in Step 1			(100)
Available profits – deduct result of Step 3 from LR profits			**400**

The restriction ensures that the deficit carry back does not displace BLAGAB management expenses and does not reduce the I-E profit below zero. The total 2016 ‘I’ of £800m is now reduced to zero by £400m of management expenses and £400m of loan relationship deficits carried back. The net 2017 deficit of £450m is reduced to £50m which is carried forward as a deemed management expense.

In this case, for Company A, the S73 amounts above are before any S389 claims for that period or later periods but taking account of any CTA carry back amounts.

For accounting periods ending on or after 15th September 2016, net deficits arising under CTA2009/Part 8 on intangible assets are treated as a deemed BLAGAB management expense for that period. Prior to the changes made in 2016, net deficits on intangible assets were carried forward to the next accounting period and treated as deemed management expenses of that period. These changes were made to align the treatment of life companies' intangibles with other companies.

See also LAM08000 for summary of all the rules for all available loss offsets.

LAM03070: Derivatives not treated as Loan relationships CTA2009/Part 7: FA2012/S74(1)(c)

The treatment of derivatives is set out in the Corporate Finance Manual at CFM 5000. Most derivatives, including those held by a life company will be treated as loan relationships. There are some exceptions where these are subject to capital gains tax rules. In general this will be because the underlying assets are equities or property or as a result of specific anti-avoidance rules.

The provisions that tax certain derivatives other than as loan relationships, as set out in the Corporate Finance Manual, apply equally to life companies as to other companies. Where the specific conditions are met certain derivative contracts will be taxed using the capital gains rules. CFM 55000+ provides guidance on the CG aspects of derivatives. CFM 55010 contains a useful guide to the instructions on the CG aspects of derivatives.

CFM54020 summarises the special rules that apply to insurance companies.

Further detail on a number of the life specific provisions is set out below.

Simple derivatives held by a company carrying on long-term business: CTA2009/S591

Life insurance companies may use for example, equity derivatives primarily in order hedge a portfolio of equities. Since BLAGAB chargeable gains and losses on shares fall within the TCGA regime it is appropriate to keep derivatives which are hedging those shares within that same regime.
CTA2009/S589 excludes from treatment as a loan relationship certain contracts, dependent on conditions (listed in CTA2009/S591) and their subject matter. One such derivative (CTA2009/S591(2)) is a simple derivative contract held by a life company.
Such a contract will be excluded by virtue of Condition A if it is a “plain vanilla” contract (i.e. one that is not an embedded derivative nor has another derivative embedded in it) entered into or acquired by a company carrying on long-term business and the contract is an approved derivative for the purposes of the PRA Sourcebook for Insurers (FSMA2000)- the PRA rulebook . For that purpose a derivative is approved if:

- it is held for the purpose of efficient portfolio management or reduction of investment risk
- it is covered; and
- it is effected or issued:
    - on or under the rules of a regulated market; or
    - off-market with an approved counterparty and, except for a forward transaction, on approved terms and is capable of valuation.

See PRA Rulebook for guidance about the meaning of these terms. Note that a derivative may be treated as held for the purpose of efficient portfolio management if the firm reasonably

believes the derivative or quasi-derivative (either alone or together with any other covered transactions) enables the firm to achieve its investment objectives by, among other things, reducing tax (INSPRU 2.3.6(2)). That does not prevent the contract from falling within Condition A and so not being within Part 7.

This rule does not apply to any contract treated as a "quasi-derivative" for the purposes of the PRA rulebook. This means that structured products, such as equity derivatives backing guaranteed income bonds and those designed to provide a guaranteed amount including prepaid equity derivatives with a floor or guaranteed equity bonds, are not excluded.

Embedded derivatives treated as meeting condition in CTA2009/S591

CTA2009/S592 identifies cases where an embedded derivative (which itself is treated under accounting standards as such) is to be treated as meeting the CTA2009/S591 conditions. It applies where there is a 'hybrid derivative' (CTA2009/S584) which, due to the size of the initial outlay, is not treated as a derivative but as a financial asset or liability, with the host contract also treated as a financial asset. The effect is to treat the embedded derivative as a chargeable asset and the host contract as a creditor relationship. This legislation aims to match the derivative tax treatment to that of the derivative contract's underlying asset. See CFM52580 for further detail.

Derivative contracts embedded in loan relationships: chargeable gains treatment CTA2009/S635

Convertible (including exchangeable) securities and asset-linked securities whose underlying subject matter is shares are sometimes held by life insurance companies. They are analysed for accounting purposes as being in substance loans (creditor relationships) with embedded derivatives which provide the convertibility feature (an option) or the index or asset value-linked feature (a contract for differences).

A company that accounts for a creditor relationship at fair value through profit and loss would not, in general, bifurcate (i.e. be split in two) into an embedded derivative and remaining loan relationship rights. To ensure there is no mismatch between the tax treatment of the derivative and the underlying subject matter of the derivative contract CTA2009/S635 applies where there is a creditor relationship with an embedded derivative held for the purposes of BLAGAB. The tax treatment applying to bifurcated instruments is to apply whether or not fair value accounting (and so no accounting bifurcation) applies.

In relation to creditor relationships with embedded derivatives which meet certain conditions, chargeable gains treatment is given to the derivative element. See CFM55410 onwards for further information.

LAM03080: Land and Property- Separate property business and losses from property business: FA2012/S74(1)(a)

FA2012/S86 and S87

CTA2009/ Part 4 sets out special rules for the corporation tax charge on income from property business. Long-term insurance business is excluded from the provisions of Part 4 CTA2009/S201 that specify rules for calculation of property business profits, so that, for example there is no requirement to split UK and overseas property business.

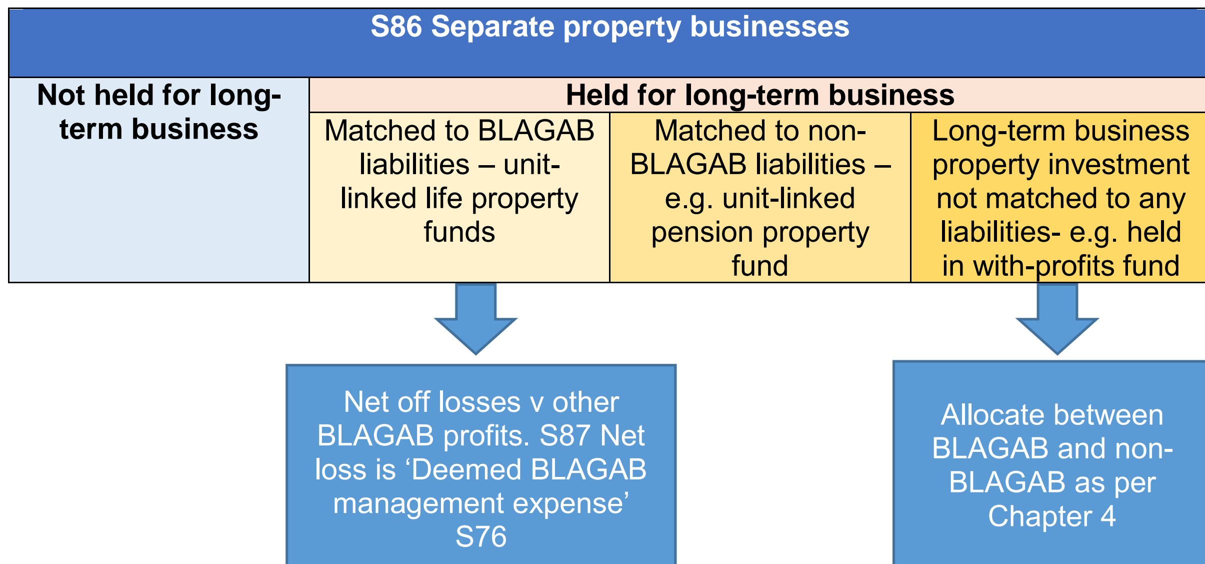
FA2012/S86 modifies those provisions and treats income from land, as set out below, as separate businesses for the purposes of applying the I-E rules. Note that non-BLAGAB

property is outside the I-E rules and will form part of the non-BLAGAB trade profit. LAM07100 explains the rules that apply to trade profit.

The separate businesses are illustrated in the diagram below.

FA2012/S87 dis-applies, for the purposes of I-E, the rules for utilisation of property business losses in CTA2010/Part4/Chapter 4 and introduces rules that cater for the separation of the different property businesses. The effect is shown in the diagram below.

This divides, under FA2012/S86(3), property business into business where assets are held, or held other than, for long-term business. S86(4) then splits assets held for long-term business into three (i) those matched to BLAGAB liabilities (e.g. unit-linked business) (ii) those matched to non-BLAGAB liabilities (iii) those not matched to long-term liabilities (e.g. held in a with-profits fund) (S86(4)). These categories reflect the split required for assets to identify BLAGAB chargeable gains and losses LAM03210. The split of assets not matched to BLAGAB and non-BLAGAB will reflect the apportionment provisions set out in chapter 4 to identify the proportion of those assets referable to BLAGAB.



BLAGAB property losses can be set off against other BLAGAB profits. A S87 net loss is a deemed management expense under S76 LAM04200.

Where property is partly matched to a long-term liability only that part of the asset is counted as matched (FA2012/S86(5)).

The effect of S86 is to ensure that the normal rules in CTA2009 for calculation of income from property still apply to BLAGAB property business, but the BLAGAB profits are separately identifiable. The separate treatment of land matched to a BLAGAB or other long-term liability (S86(5)) enables the tax rules to be more closely aligned with the commercial position as the tax on those assets is not impacted directly by the tax position of other property investments.

In other words, a BLAGAB unit-linked policy linked to property assets will have the tax suffered by the company on those assets deducted from the liabilities to the policyholder as an expense. The actual tax suffered by the company, should, by virtue of the separation of the tax on BLAGAB matched assets be capable of being aligned with that tax charge against the policy liabilities. This tax is effectively suffered by the policyholder ultimately via a reduction in benefits paid on redemption or maturity.

However, if there were net property losses, they can be set against any other BLAGAB property business profits (S87(4)) before being treated as a deemed management expense (S87(3)).

Gains and development activities

Disposals of interests in land by life companies referable to BLAGAB are taxed under normal capital gains tax rules. As for companies generally, if life companies hold property primarily to make profits from development value a charge to tax on profit as income (as opposed to capital gains) could potentially arise under CTA 2010/Part 18 or from 5th July 2016, CTA 2010/ Part 8ZB. In practice, life insurers generally hold property for the long-term and this may include development activity as part of its life insurance investment activity.

Further detail on capital gains treatment of land related transactions is in the capital gains tax manual

LAM03090: Miscellaneous income and losses: FA2012/S74(1)(j): FA2012/S89

S74(1)(j) ensures that miscellaneous amounts taken out of charge by FA2012/S68-69 which would normally be chargeable under CTA2010/S1173 (except for non trading gains on intangible assets under S752) are brought into the I-E computation in so far as they are referable to BLAGAB. The relevant items are listed in S1173.

These amounts are unlikely to be material for a life company. However, life companies should be able to reconcile the income brought into charge to tax to the income included in the statutory accounts of the company. This should enable any material items of income not already taken account of in the tax computation to be identified. Profits on items treated as capital in the accounts may be more difficult to identify but insurers should be able to demonstrate how they have ensured all items in the accounts have been identified and included in the tax computation.

S89 provides for the offset of miscellaneous losses against miscellaneous profits. Any net excess miscellaneous losses are carried forward to the next accounting period as a deemed BLAGAB management expense for that next period.

LAM03100: Stock lending and Repos: TCGA1992/263B-C, CTA2009/S546

Life companies may have stock lending and/or repo income or profits although they are not usually a significant component of ‘I’.

Stock Lending

There are long-established and well-regulated arrangements under which institutional investors, such as insurance companies and pension funds lend securities to dealers who are market makers. Stock loans involve a temporary transfer of the legal ownership of securities, while the economic ownership is retained by the original owner. TCGA1992/S263B and 263C provide for the non-recognition of all stock lending transactions for the purposes of corporation tax on chargeable gains (relevant only to equity lending) except where it becomes apparent that the securities will not be retransferred. See CFM74140 onwards.

Repos

A company carrying on life insurance business may also enter into a lending “repo” transaction in order to earn a secure return for cash better than it could get from depositing it with a bank. Under such a repo the “lending” life company acquires securities for cash with a related

agreement to resell them, the transaction being in substance a loan secured on the collateral of the securities (see CFM46010 onwards). A repo differs from a stock loan in that the transaction is legally one of purchase and sale for a cash consideration. The legislation on repos is in CTA2009/Part6/Chapter 10. S546 provides that the price differential is taxed as if it were interest. The sale or resale is still ignored for the purposes of corporation tax on chargeable gains (FA2007/Sch13/para11) and for the purposes of CTA 2009/ Part 5 (loan relationships) CTA 2009/545.

In practice, the treatment for a life company is not different to that for any other company with net profits in the accounts being included in the I-E tax computation as loan relationship income.

LAM03200: Step 2 FA2012/S73 Calculating BLAGAB chargeable gains - an overview: FA2012/S75

The tax treatment of chargeable gains and losses referable to BLAGAB within the life company is based on the chargeable gains rules applicable to companies generally, with modifications. It is intended to provide a proxy for the tax that the policyholder might have paid on chargeable assets if they were held directly. It is a rough proxy as the life company is able to claim indexation allowance on gains but the charge on the company takes no account of the fact that policyholders have an annual capital gains tax free allowance.

This guidance only covers the modifications of the normal corporation tax rules applicable to capital gains that apply to life companies and not the general rules. The general capital gains rules can be found in the Capital Gains Manual. Gains and losses on assets referable to non-BLAGAB are not subject to these rules. LAM07000 (trade profits chapter)

The table at LAM03040 sets out the main types of chargeable assets that may be held by a life company and indicates where these fall within the chargeable gains provisions.

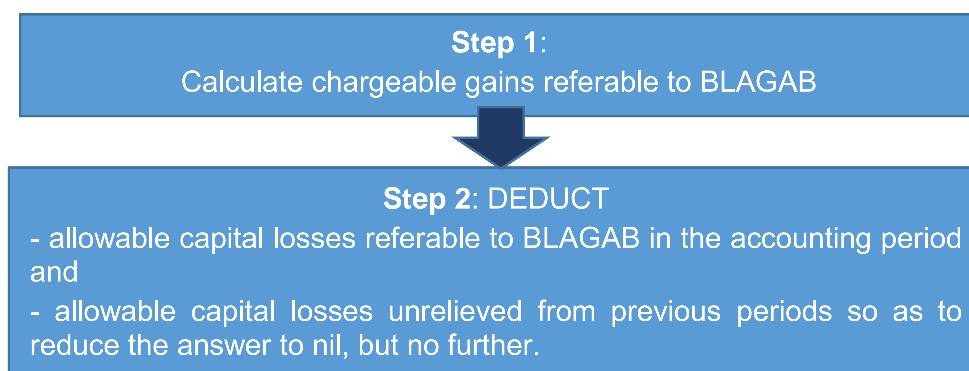
The requirement to include BLAGAB chargeable gains and losses in the calculation of "I" is set out in FA2012/S73 step 2:

> 'calculate the BLAGAB chargeable gains of the company for the accounting period as adjusted for allowable losses'

The method of calculating BLAGAB chargeable gains is set out in steps in FA2012/S75.

In summary, the legislation requires calculation of chargeable gains and allowable losses on disposals of assets held for the purposes of the company's long-term business (taking no account of any assets within 'long-term fixed capital') in accordance with the rules in TCGA1992 FA2012/S75(4). The gains and losses involved are only those that are "referable" to BLAGAB (covered in more detail in the apportionment rules explained in LAM05000).

Having identified the chargeable assets, the two steps in S75 are:



The basic rules relating to chargeable assets and calculating gains and losses are those contained in TCGA1992 and explained further in the Capital Gains Tax Manual. The calculations generally follow these basic rules. There are however certain areas where the BLAGAB rules diverge from the basic rules, or where additional rules are overlaid on the standard rules. The principal differences are:

- 'CGT boxes', transfers and intragroup rules as referred to above: LAM03210/03220 Related to the CGT boxes are the share pooling rules which specify separate pools for calculating gains within the company LAM03230
- Deemed mark to market annual gains disposals for certain collective investment or similar vehicles (including unit trusts, OEICs, offshore funds) with-profits arising spread over 7 years and specific rules for losses – see LAM03300-03350
- Substantial shareholdings exemption: the definition of a 'substantial shareholding' is amended in TCGA1992/PARA17(1) to substitute '30%' for long-term business assets (excluding LTBFC) instead of the 10% holding required for other assets. Rules apply for aggregation within the group, to deal with the interaction between the SSE and box transfers, derivatives, convertibles and options LAM03720-03740
- Anti-avoidance provisions: bed and breakfasting rules as modified by TCGA1992/S210B to restrict losses on certain disposals where there is reacquisition shortly thereafter. These rules specify the order of set off and allow for certain exceptions. LAM03710
- Losses: although BLAGAB gains and losses are largely ring fenced from other company gains and losses, there may be a share of the BLAGAB gains that are treated as shareholder TCGA1992/S210A. Any such gains can be offset by shareholder capital losses up to the amount that reduces the I-E to nil FA2012/S95(1). LAM03410 In addition the shareholder's share of BLAGAB capital 'allowable losses' can be used to offset shareholder chargeable capital gains elsewhere in the company. LAM03400-03420

Where there are assets which are referable to both BLAGAB and non-BLAGAB, the total chargeable gain or allowable capital loss is calculated on the asset but only the part referable to BLAGAB is apportioned to BLAGAB in the tax computation. The rules for apportioning between BLAGAB and non-BLAGAB are explained in LAM05000.

LAM03210: Box Transfers: FA2012/S116

Background:

The rules for determining the extent to which a chargeable gains or allowable loss is "referable" to BLAGAB are detailed at LAM05100. In summary where assets are "matched" with BLAGAB liabilities the gains on disposal (or deemed disposal) of those assets will be referable to BLAGAB. If the assets are not matched then they will be allocated on the basis of a commercial method.

As the chargeable gain element of "I" is transaction based (in that the accrued gain/loss only comes into charge on a disposal) there is a potential distortion and vulnerability in the life company apportionment rules as they relate to gains. This is because a gain can accrue, perhaps over many years, while an asset is "matched" to one type of business. However, the gain may crystallise when the asset is matched with a different type of business, since the "matching" is simply an internal allocation of assets by the business, not generating a disposal for gains purposes. For example, absent special provisions, it would be possible to change

the matching of a BLAGAB asset so that it becomes a pension (non-BLAGAB) matched asset prior to disposal and therefore not generating a chargeable gain in the I-E profit calculation.

In order to address this risk, the legislation contains what has become known as the box transfer rules. These provisions ensure that a company cannot avoid tax by shifting assets internally between specified categories or ‘boxes’ which have different tax treatment.

The provisions deem a disposal to take place to crystallise any chargeable gain or loss accruing up to the point at which assets are transferred between categories of business or ‘boxes’. The deemed disposal is at fair value. This is an essential part of ensuring that the commercial allocation rules work properly.

The ‘boxes’ were also a feature of the pre-2013 legislation. Although the pre 2013 categories were different the broad intention was the same with the differences mirroring the apportionment rules in LAM04000. The transitional rules to deal with the shift from the old boxes to the new are referenced in LAM12070.

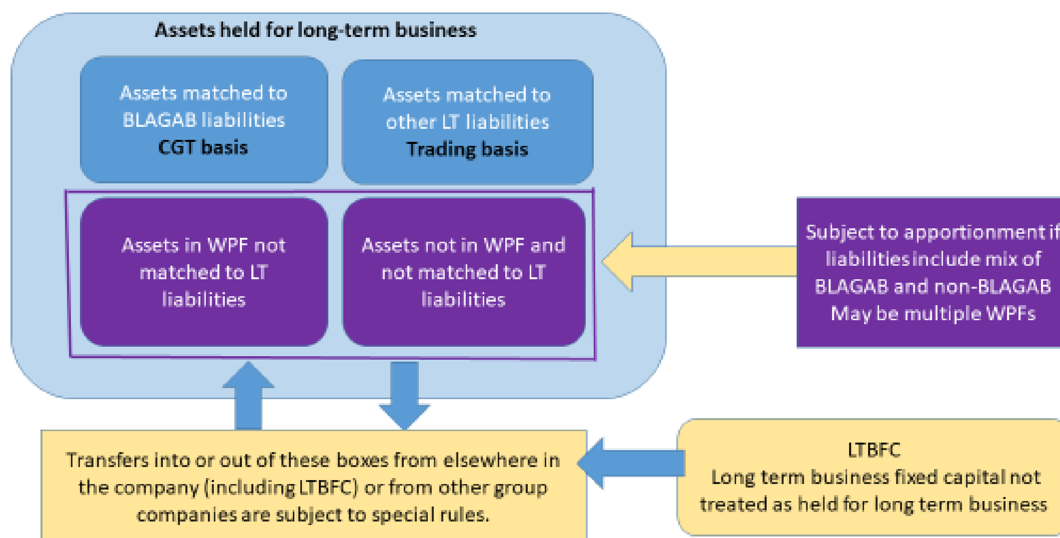
The rules on boxes make reference to specific pools of assets. A life company may be managing certain collections of assets separately. These could be held to match specific policyholder liabilities such as in the case of unit-linked policies. Companies may have one or more ‘with-profits funds’ where policies within the fund are entitled to a share of the profits of the business and in such cases the assets are held in a separately managed pool. There may also be separately managed pools held to comply with requirements arising from transfers of business or as part of capital requirements for regulatory purposes. For example as below:

Internal Unit-linked funds	Assets backing liabilities to policyholders where the benefits under the policy are linked to the value of those assets
With profit ‘WP’ funds	Assets backing liabilities under WP policies where benefits are in whole or part dependent on the profits of WP fund: typically, but not always, profits are split 90:10 or in some cases 100:0 between policyholders and shareholders
Sub funds within WP funds businessbusines	These are separate pools of assets within the WP fund with their own rules for sharing of profits. There may be sub funds within funds – often set up as part of a transfer of business. These may be 90:10 or 100:0 (i.e. wholly policyholder) and/or have special restrictions on use of the funds

The rules for “boxes” may reflect these commercial arrangements but they have their own statutory basis.

The “Boxes” FA2012/S116 Assets held for purposes of long-term business

The rules for “boxes” of assets are in FA2012/S116. Under these rules the following four categories in the long-term business below are regarded as separate ”boxes”:



There are potentially four types of boxes to consider:

- Assets matched to BLAGAB liabilities
- Assets matched to other long-term liabilities
- Assets in a with-profits fund not matched to LT liabilities
- Assets not in a with-profits fund and not matched to long-term liabilities

Gains and losses on non matched assets will be subject to apportionment if liabilities include a mix of BLAGAB and non-BLAGAB .

If there is more than one with-profit fund in the insurance company, each with-profit fund is treated as a separate box- FA2012/S116(3). Additionally there may be a box for with-profits fund assets not matched to a specific with-profits fund.

Transfers into or out of these boxes from elsewhere in the company (including LTBFC) or from other group companies are subject to special rules.

‘Assets matched to liabilities’ is defined in FA2012/S138. An asset is matched to a liability if, in accordance with the ‘applicable method’ (broadly commercial allocation), some or all of the income or other return arising from that particular asset is specifically referable to that category of business.

To be ‘specifically referable’ the allocation of the income or other return is a consequence of a contractual requirement imposed on the company relating to the category of business- S138(8).This enables tax relating to assets held to back unit-linked life policy liabilities to be separately identified and calculated. Under the terms of the policy, any related tax liability will be charged to policyholders and included in policyholders’ liabilities.

Where there are assets in a life company that are not regarded for tax purposes as held for the purposes of the long-term business, there is a fifth ‘other than long-term assets’ box FA2012/S116(6)(b). This could include structural assets such as subsidiaries or ‘Long-term business fixed capital’. Transfers from and to the long-term business boxes to and from the ‘other assets’ box are subject to special rules – FA2012/S116(5). LAM03220

The Box rules are designed largely to protect the capital gains charge in respect of BLAGAB business, so it follows that the separation into the four boxes shown in the diagram above does not apply where all the income of the company's long-term business is chargeable to CT under the trading rules- FA2012/s116(4). In that case there will be at most two separate 'boxes': one for assets held for long-term business and if necessary a second for other assets- FA2012/S116(6).

FA2012/s117 applies the above 'box' rules to the assets attributed to the UK permanent establishment through which an overseas life insurance company carries on life insurance business.

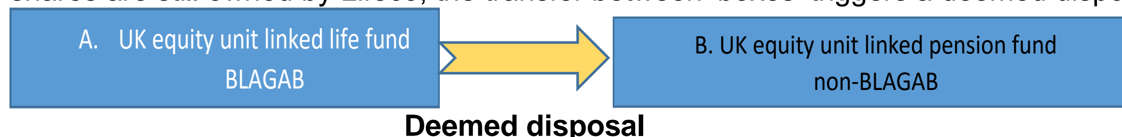
Interaction with TCGA: the appropriations to and from stock rules

The appropriations to and from trading stock rules at TCGA1992/S161 could conceivably apply in principle to a transfer to and from the 'other assets' box in S116(6)(b) to another box. However, FA/2012/S116(5) has precedence being the more specific section.

Effect of a Transfer between Boxes

On the transfer of an asset (or part of an asset) between 'boxes' in the long-term business categories, FA2012/S116(1) provides that for the purposes of CT on chargeable gains there is a deemed disposal and reacquisition at fair value. Where an asset moves from the matched non-BLAGAB box to matched BLAGAB box there will be no chargeable gain (because of the effect of TCGA1992/S37 and S39 LAM07100). The base cost for any future disposal from the BLAGAB box will be calculated by reference to fair value at the time of the transfer.
Example Deemed disposal

Lifeco has a UK equity unit-linked life fund (A), holding shares which are matched to its BLAGAB business. It also has a UK equity unit-linked pension fund (B)
Shares are reallocated internally from A to B at market value of £500k. Although the shares are still owned by Lifeco, the transfer between 'boxes' triggers a deemed disposal



Deemed disposal

The capital gain is based on the market value of £500k less A's CGT base cost of, say, £300k (including indexation and costs of sale).
There is a gain of £200K to include in Step 1 of FA2012/S75. That gain will be apportioned following the normal rules (so if the asset was matched to BLAGAB business before the reallocation all the gain will be BLAGAB)
The shares are now held at market value and any subsequent increases in value are computed accordingly.

Without the 'boxes' Lifeco could transfer the shares with no taxable gain arising as the shares remain owned by Lifeco throughout. After transfer, the shares would be within the pension unit-linked fund where any increases in value may be treated for tax purposes as accruing for the benefit of policyholders and will be reserved in the accounts. Accordingly any increases in value will not directly create additional tax liabilities for the company.

If the transfer was between two with-profits funds where there was a mix of BLAGAB and non-BLAGAB, there would again be a deemed disposal of the whole of the asset from one WP

fund share pool to the other, with only the proportion referable to BLAGAB being added at Step 1 of S75 (or step 2 if there was a loss). Modifications to the share pooling rules facilitate this separate treatment of assets in different funds for disposals of shares which are normally held in a single pool for capital gains tax purposes. LAM03230

LAM03220: Life companies as capital gains tax group member

Background

Many companies carrying on life insurance business are members of groups of companies. In the same way that specific rules are required to address internal reallocations of assets between different tax categories or boxes within the life company, rules are required to address transactions between the life company and the rest of the group.

Life company specific rules

The normal provisions for transactions between members of groups of companies apply to intragroup transactions involving life insurance companies subject to the following exceptions:

1. FA2012/S118(6) dis-applies the no gain no loss rules at TCGA1992/S171 and S173 on any transfer of long-term business assets (excluding LTBFC) from or to another group member.

2. Exceptions to TCGA1992/17-18 connected party rules to restrict offset of losses to gains arising on disposals with the same connected person; S18(3) dis-applied where the life company disposes of assets to the 'manager' of an 'authorised investment fund' TCGA1992/S210C(1) . This provision recognises that life companies may have a manager of an authorised investment fund within their group as part of their fund management operation. Transfers to and from the authorised investment fund manager would be in the course of normal investment activity and S18(3) prevents these transfers being caught by what is an anti-avoidance provision.

3. TCGA1992/S171A provides for an election to offset gains in one group company 'A' against losses in another 'B' without the need to transfer the assets. If A is a life company, a S171A election cannot be made for a (non-LTBFC) asset as S171 would not apply to an actual transfer i.e. life fund gains cannot be shifted to another entity.

   Gains can be shifted from a non-life company into a life company but they cannot be offset by BLAGAB losses except insofar as TCGA1992/S210A then allows.

4. Specific rules for transfers of business – LAM13000

Note that for a 'qualifying friendly society' (ICTA88/S461B) the no gain no loss rule is fully prevented from applying by TCGA92/S171(2)(cd). CG45320

Example

Lifeco A has a UK equity unit-linked life fund (A) and transfers shares from A to another group (holding) company B at market value of £500k.

A. UK equity unit linked life fund BLAGAB

B Group holding company

The disposal from Lifeco A to company B would normally be covered by S171 but this is dis-applied by FA2012/S118(6)
The BLAGAB capital gain in A is chargeable based on the market value of £500k less A's CGT base cost of £300k (including indexation and costs of sale). There is a gain of £200K to include in Step 1 of FA2012/S75.
B acquires the shares at market value and any subsequent gains are subject to the normal capital gains legislation.

In the example above, it would not be possible to elect under S171A to deem the gain to arise in B to offset a capital loss in that company as S171 would not apply to an actual transfer.

If instead company B has a loss it can elect to deem this loss to arise in company A. However, under S171C (4) the loss would be treated in A as arising in the 'other than long-term assets' box as a 'non-BLAGAB' loss for the purposes of ring fencing TCGA1992/S210. Accordingly it could not be offset against the gain on the asset arising in the unit-linked life fund, (except to the extent of the shareholders share of the gain in A - FA2012/S95 and TCGA1992/S210A LAM03400).

Note that 'non-BLAGAB' allowable losses in this context means 'allowable losses of the company which are not BLAGAB allowable losses' S210A(13). This is distinct from (and pre-dates) the term 'non-BLAGAB' used elsewhere in this manual relating to the categories of business excluded from BLAGAB in FA2012/S57.

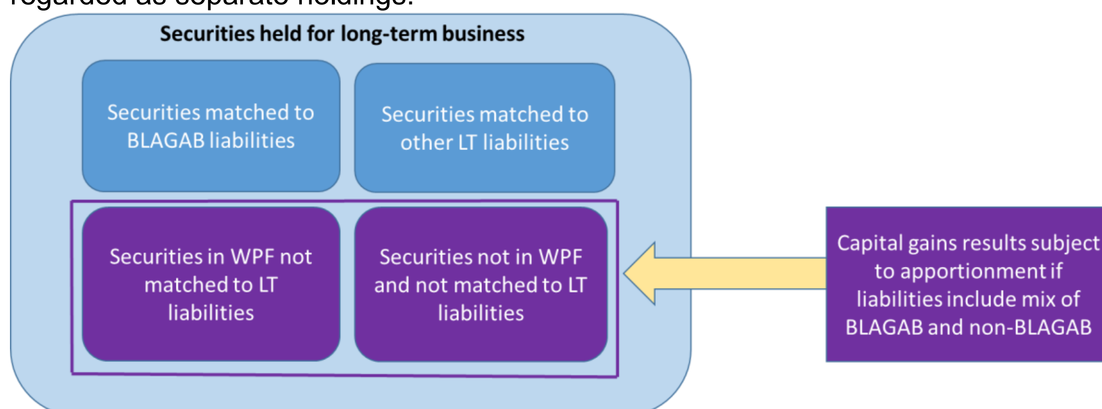
If both A and B are insurance companies and the gain or loss arose on an asset being transferred out of its long-term business fund, then S171C(3) overrides S171C(2) so that FA2012/S118(6) again applies and takes the transaction out of S171, which in turn means that the companies cannot make a S171A election to transfer the gain or loss between them

LAM03230: Transactions in shares: Share pooling rules: FA2012/S119-121

Life insurance companies have, since the 1930s, been active in acquiring equities.
They are one of the largest single group of shareholders and certainly the largest taxable group. Most holdings in quoted companies are of ordinary shares, but life companies also hold preference shares, particularly in unquoted companies.

The general share identification rules for companies apply to Life insurance companies (See CG51600). Part of those rules include the capital gains tax pooling rules in TCGA1992/S104.Those pooling rules are not sufficient for Life insurers because pooled shares under S104 may be held to back different types of business. Accordingly, there are special share pooling rules for insurance companies (FA 2012, s. 119), which follow a similar

pattern to the box transfer rules. For share pooling purposes the following categories are regarded as separate holdings:



If there is more than one with-profit fund in the insurance company, each with-profit fund is treated as a separate holding for share pooling purposes- FA2012/S119(2).

'Assets matched to liabilities' is defined in FA2012/S138. An asset is matched to a liability if, in accordance with the 'applicable method' (broadly commercial allocation), some or all of the income or other return arising from that particular asset is specifically referable to that category of business.

To be 'specifically referable' the allocation of the income or other return is a consequence of a contractual requirement imposed on the company relating to the category of business- FA2012/s138(8).This enables tax relating to assets held to back unit-linked life policy liabilities to be separately identified and calculated. Under the terms of the policy, any related tax liability will be charged to policyholders and included in policyholders' liabilities.

Where, there are securities in a life company that are not regarded for tax purposes as held for the purposes of the long-term business, there is a fifth pool of securities that are held otherwise than for the purposes of company's long-term business FA2012/S119(1)(e)). This could include structural assets such as the shares in subsidiaries or securities that are 'Long-term business fixed capital'.

The share pooling rules for securities held for long-term business do not apply where all the income of the company's long-term business is chargeable to CT under the trading rules-S119(3). In that case there will be two separate holdings: one for securities held for long-term business and if necessary a second for securities held otherwise than for the purposes of its long-term business- FA2012/S119(4). Within the holdings required by S119 there may of course be a number of pools under the provisions of TCGA1992, such as 1982 holdings.

FA2012/S120 applies the above share pooling rules to the securities attributed to the UK permanent establishment through which an overseas life insurance company carries on life insurance business.
The share pooling rules, combined with the box transfer rules LAM03210, which follow the same pattern, allow life companies to more closely align the tax liability arising on assets to the related gains and losses that accrue to the different policyholder funds.

LAM03300: Collective investment schemes - annual deemed disposal: overview TCGA1992/S212

Gains and losses on holdings in authorised unit trusts (and other collective investment vehicles) are subject to an annual deemed disposal for chargeable gains purposes. TCGA1992/S212.

The charge arises where, at the end of an accounting period, the assets held by an insurance company for the purposes of its long-term business include the assets types below:

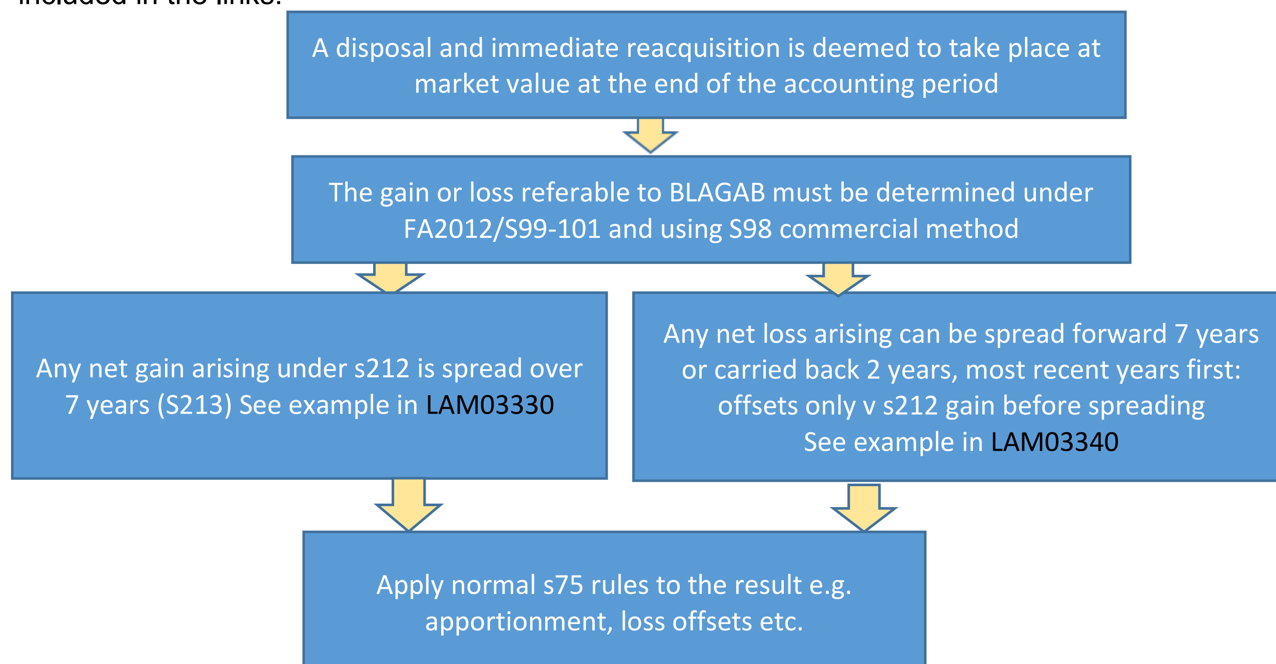
Asset type- link in this manual	Description	Further References
Authorised Unit Trust – an Authorised investment fund 'AIF'	SI2006/964	Authorised unit trusts and Authorised investment funds
Open ended Investment Company (OEIC) – also an AIF	SI2006/964/Regulation 98	OEICs capital gains tax manual
Offshore funds	TIOPA2010/PART8 and SI2009/3001	Offshore Funds Manual.
Authorised contractual scheme-co-ownership scheme	TCGA1992/103D SI2013/1400	Authorised contractual scheme guidance
UK Real Estate Investment Trust (REIT)	CTA2010/S518	Guidance on real estate investment trusts

'Bond funds' treated as loan relationships within CTA09/PT6/CH3 are not within TCGA1992/S212.

More detail on each of these categories is included in the relevant HMRC manuals. (see LAM03310)

The deemed disposal only has effect on gains which are referable to BLAGAB (using the normal apportionment rules in FA 2012) (see TCGA92/S213(1A)).

The impact of being included in these categories is summarised below and more detail included in the links:



These rules ensure that gains are not indefinitely deferred. The flexibility in loss carry back contained in the rules recognises that temporary fluctuations in value may create large gains followed by losses which may be due to the timing of the year end and temporary fluctuations rather that reflecting real overall gains.

There are in addition special rules covering:

- Cessations and transfers of business TCGA1992/S213(4) and S213ZA LAM11000
- Seeding an Authorised Contractual Scheme 'ACS' TCGA1992/S118 LAM03310
- Losses on transfers to a connected 'authorised investment manager' TCGA1992/S210C LAM03330

The application of S212 provisions to the different categories of funds is further set out in LAM03310

LAM03310: Collective investment schemes annual deemed disposal – categories of funds: TCGA1992/S212

An understanding of the different kinds of funds and what they are trying to achieve for investors is helpful in understanding the relevant tax treatment.

Collective investment schemes (CISs) enable investors to pool their assets and invest in a professionally managed portfolio of investments, with a broader spread of risk than would usually be possible from private investments. The tax rules that apply to UK CIS and their investors aim to avoid double taxation of income or capital gains, and to tax investors in a similar way to that applying to direct investors in the underlying assets. UK-resident CIS are generally exempt from tax on capital gains; investors within the charge to tax are liable to tax on any gain arising on a disposal of their shares or units in the fund.

Authorised Unit Trusts (AUTs) and Open Ended Investment Companies (OEICs)

AUTs and OEICs are Authorised Investment Funds (AIFs)- regulation 3, SI 2006/964. An AIF is not subject to tax on its chargeable gains – TCGA1992/S100. Participants, including life companies, within the charge to Corporation Tax are liable to tax on gains made on the disposal of interests in AIFs.

Units of AUTs are treated as shares for capital gains purposes- TCGA1992/S99. When calculating the capital gains and losses for a life company's holding in an AIF (where the BLAGAB proportion is chargeable) the following rules need to be considered:

- the general share capital gains rules with Part IV TCGA 1992 (CG50200C+);
- the share pooling rules FA2012/S119-120 (LAM03230);
- the bed and breakfasting rules at TCGA1992/S210B (LAM03710); and
- the specific collective investment schemes capital gain rules within Part III, Chapter 3 and 4 TCGA 1992 (CG57680P+).

Offshore funds

An offshore fund is a defined category of 'mutual fund' resident in, or based in, a territory outside the United Kingdom. The offshore funds manual explains investors who are within charge to UK tax and who have invested in an offshore fund are liable to tax on income and gains.Life companies may have some investments in structures in overseas jurisdictions that do not fit neatly into the various categories of mutual fund – see the offshore funds manual for further advice.

Co-ownership Authorised Contractual Schemes (Co ACS)

A Co-ownership Authorised Contractual Scheme (Co ACS) is a UK collective investment scheme which is constituted on a contractual basis and is transparent for the purposes of tax

on income. A Co ACS is a pool of assets held and managed on behalf of a number of investors who are the co-owners of the assets.
A Co ACS is not within charge to direct taxes. For capital gains tax in relation to a Co ACS, TCGA1992/103D disregards investors' share of the underlying assets held by the CoACS and treats investors' units in the Co ACS as a chargeable asset.
TCGA1992/103D contains rules to help life companies calculate the S212 gain on an annual deemed disposal.

Real Estate Investment Trust (REIT)

A Real Estate Investment Trust (REIT) is a vehicle that allows an investor to obtain broadly similar returns from their investment, as they would have, had they invested directly in property. The vehicle is a limited company (or a group of such companies), required to invest mainly in property and to pay out 90% of the profits from its property rental business to shareholders.

The UK-REIT is exempt from tax on profits on its property rental business, including income and chargeable gains on direct disposal of property. The Real Estate Investment Trust Manual contains further details.

There are two specific life tax rules which aim to prevent life companies using REITs to defer tax on gains:

- Inclusion of REITS in the definition of S212 assets
- Prohibition on life companies (or any 75% subsidiaries) being a member of a 'group REIT'

Permanent Establishment

TCGA1992/S212 applies to an overseas life insurance company in relation to their UK assets. Assets (whether situated in the United Kingdom or elsewhere) are "UK assets" if they are attributed to the permanent establishment in the United Kingdom through which the company carries on life insurance business.

Interaction with the CFC charge

As life companies may have significant holdings in offshore funds and collectives, these may trigger a controlled foreign company charge. Where TCGA1992/S212 applies this could result in double taxation. Regulations in SI 2012/3044 prevent this double charge arising. This is explained in LAM12010.

LAM03320: Collective investment schemes not subject to TCGA1992/S212

Investment Trusts

Shares in UK investment trust companies are not included in the 'S212 assets'.

Unauthorised Unit Trusts

Unauthorised unit trusts are established for a variety of reasons. They may be used to invest in property where the lack of liquidity prevents a trust from being authorised, or they may be used where the class of unit holders is a restricted one. The capital gains of an unauthorised unit trust are assessable to Capital Gains Tax on the trustees unless the trust is classified as

an exempt unauthorised unit trust (EUUT) – see The Unauthorised Unit Trusts (Tax) Regulations 2013 (SI 2013/2819).

An EUUT's issued units are held throughout the year of assessment by 'eligible investors' which are either wholly exempt (other than by reason of residence) from the charge to Capital Gains Tax or corporation tax on chargeable gains - or for insurance companies ignoring any corporation tax on income. Examples would be pension funds and life companies writing unit linked pension business. There are no life specific rules for UK resident UUTs and these holdings are not within S212.

Bond Funds

Relevant Interest in OEICs, authorised unit trusts and offshore funds that fail to satisfy the qualifying investments test are excluded from S212 as they are subject to tax as loan relationships. The qualifying investment test requires that interest related securities related instruments and derivatives do not exceed 60% of their total assets, at any time during a company's accounting period. CTA2009/490(7) excludes from relevant holdings transparent funds, where income is taxed directly on the investor. The full explanation of the rules on 'bond funds' is in the Corporate Finance Manual (see CFM43000).

Life company relevant holdings in a bond fund are creditor loan relationships and the holdings must be accounted for and taxed in accordance with the loan relationship rules. Any interest distributions from bond funds, along with any increase in value of the holding, are credits within CTA2009/ Part 5/S490(2) and (3).

The same valuation rules apply to derivative contracts held by a company whose underlying subject matter is an interest in a bond fund CTA2009/587.

As the loan relationship rules have precedence over other corporation tax rules, where the bond fund rules apply S212 will not.

Partnerships

Where a UK life company holds an interest in a partnership it is liable to corporation tax on gains as they accrue, S212 should not be applied to the holding. See LAM03600 for simplification of the capital gains tax rules that facilitate calculation of partnership gains for venture capital partnerships in certain circumstances.

LAM03330: Spreading of deemed disposal gains: TCGA1992/S212

TCGA1992/S213(1) and (1A) spreads the aggregate of the gains and losses on deemed disposals (called the 'net amount') referable to BLAGAB in an accounting period over seven years. Special rules apply to losses.

The gain of £700m in 2017 would result in a 'deemed disposal' chargeable gain of £100m in

Example
Company A acquires OEICs during the accounting period 31st December 2017 valued at £3.5billion which are wholly backing BLAGAB business.
There is a net chargeable gain the 'net amount' arising across the OEIC portfolio of £700m in 2017 and £1,050m in 2018.

£'m	Total	2017	2018	2019	2020	2021	2022	2023	2024
2017	700	100	100	100	100	100	100	100	
2018	1050		150	150	150	150	150	150	150
Chargeable		100	250	250	250	250	250	250	150

2017 and £100m each year through to 2023. The gain of £1050m would result in a chargeable gain of £150m each year from 2018 through to 2024.

Any subsequent net BLAGAB gains or losses in 2019 and later would be similarly spread and added to these amounts for 2017 and 2018. This is subject to any loss carry back. LAM03340

The resulting chargeable amount would then be added to any other BLAGAB chargeable gains or could be offset by BLAGAB chargeable losses. Any apportionment where assets are partly backing BLAGAB and partly backing non-BLAGAB would be carried out before any spreading.

For the current accounting period, in the example 2017, 1/7th is brought into account regardless of the accounting period length. For subsequent accounting periods of less than a year the fraction of 1/7th is proportionately reduced

Where there is an actual disposal of an s212 asset in an accounting period, the chargeable gain or allowable loss is not spread. The gain or loss is calculated with reference to the last deemed disposal. Any previous deemed disposals on those assets continue to unwind as before.

LAM03340: Deemed disposals losses offset and carry back: TCGA1992/S213(3)

Losses can either be spread forward for 7 years (as above example) or carried back for two accounting periods. In the example above, if the £700m was a loss the 'net amount' and there were no other BLAGAB chargeable gains and no gains in prior years for carry back, the numbers would change as follows:

£'m	Total	2017	2018	2019	2020	2021	2022	2023	2024
Loss b/fwd			(100)	(50)	0				
2017	(700)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	
2018	1050		150	150	150	150	150	150	150
Chargeable		(100)	(50)	0	50	50	50	50	150

In total there would be £350m of chargeable gains – the £1,050m less £700m. A loss of £100m is carried forward at the end of 2017, added to the spread loss of £100m in 2018 and offset against the £150 spread gain leaving £50m loss carried forward to 2019. In 2019 there would be £150m loss total (£50m carried forward and £100m 2019 spread loss) to offset against the £150m gain in 2019. Therefore there are no net chargeable gains in 2017, 2018 and 2019. In 2020- 2023 there is a net £50m gain in each year using up all the spread loss. In 2024 the full £150m gain is chargeable.

Carry-Back of Losses TCGA1992/S213(3)

The deemed disposal provisions result in a charge to tax on unrealised gains. It is possible that due to a fall in market values a S212 gain which is charged in one year is reduced or eliminated in the following year. Over the longer period there might be no appreciation and to allow for this possibility S213(3) provides for the carry back of any net amount of S212 losses (i.e. any excess of aggregate losses for the year over aggregate gains on S212 assets before spreading) and offset against the net amount in the two previous accounting periods.

S212 losses can only be carried back for set-off against previous S212 gains. The net amount of losses is determined before spreading.

The losses are to be relieved against the net amount of gains (before spreading) of a later accounting period in preference to an earlier one. This would enable the 'loss' resulting from a S212 disposal to be offset against the most recent reversal of a previous period increase in market prices.

Claim for Carry Back

The company must make a claim for the carry back of the loss within two years of the end of the accounting period in which the loss arose. The claim can be in respect of the whole or just part of the loss. Losses not carried back can be used, after spreading, against other non-S212 gains of the year, or carried forward like any other capital loss.

Example

Taking the example shown in LAM03330 and assuming that a claim is made under S213(3) by 31 December 2021 to carry back the 2019 losses.

BLAGAB S212 gains y/e 31 12 17	£700m
BLAGAB S212 gains y/e 31 12 18	£1050m
BLAGAB S212 losses y/e 31 12 19	£(550)m

	Total	2017	2018	2019	2020	2021	2022	2023	2024
Loss cfwd					(0)				
2017	700	100	100	100	100	100	100	100	
2018	1050		72	72	72	71	71	71	71
Less loss C/b	(550)								
Net amount	500								
2019	(550)								
Chargeable	1200	100	172	172	172	171	171	171	71

The whole of the £550m loss which is the net amount in 2019 can be carried back to 2018 and offset against the whole of the net amount for 2018. This reduces the 2018 net amount of £1050 gain to a gain of £500m, The £500m is then spread over seven years at £71.42m per annum. The £700m gain in 2017 is unaffected by the carry back and is spread over 7 years from 2017.

This results in total spread gains in 2017 of £100m, in 2018-2023 of £171.42m and in 2024 £71 totalling £1200m.

In summary, once the carry backs have been offset, all the gains and losses on all s212 disposals in the period are totalled at the end of the accounting period If there is a net gain, one-seventh of this amount is a single chargeable gain. If there is a net loss, one-seventh of this amount is a single allowable loss (to the extent it is not carried back).

The remaining six-sevenths are spread equally over the next six years. For each accounting period, the amount spread is a single chargeable gain or allowable loss that accrues on the last day of that period. So, if there are year-long accounting periods, and no allowable losses (or amounts transferred-in under Part 7), a company will have seven chargeable gains accruing as a result of ss212, all accruing at the end of each period.

Chargeable gains and allowable losses also accrue on the actual disposal of an asset within s212. In that case, gain or loss will be calculated by reference to the market value at the date of the last deemed disposal. Chargeable gains and allowable losses on actual disposals are not spread. Where there is an actual disposal, earlier deemed disposals continue to unwind over the normal spreading period (save for the potential clawback for ACSCSs see LAM03350).

Restrictions on Carry Back where Change of Ownership

Where a company joins a group in an accounting period,

- a net loss on S212 assets from a later period can still be set against gains accruing under S212 on the last day of the joining period (because those gains will by definition be post-entry gains).
- a net amount of loss on S212 assets accruing at the end of the joining period is restricted so that only so much of the loss that accrues on assets which the company held at the beginning of the period can be carried back to an earlier period – S213(8H*)*.
- a net amount of loss on S212 assets from a later period cannot be carried back to a period earlier than the joining period – S213(3)(ca*)*.

5.

The Loss Buying Provisions and TCGA1992/S212

There is a special rule for S212 losses in the capital loss buying provisions to prevent the spreading rules creating a unique loss buying opportunity. When a company joins a group, TCGA1992/Sch7A/PARA1(10) treats losses under S212 as accruing in the year of deemed disposal, not in the year to which they are spread forward i.e. for the purposes of the loss buying rules a loss arising in 2017 and spread over 2017 to 2023 is treated as a 2017 loss.

LAM03350: Deemed disposals: cessation/transfer of business; seeding an Authorised contractual scheme: losses on disposal to connected 'authorised fund manager'

Cessation/transfer of business;

If a UK company, or a UK permanent establishment of an overseas company, ceases to carry on long-term business before all of the spread gains have been brought into charge, any gains that have not been charged to tax in earlier accounting periods are brought into charge in the accounting period ending with the cessation of long-term business – TCGA1992/S213(4) andS213(4ZA).

This rule does not apply where there is a Part 7 FSMA transfer of business and certain conditions are met – see LAM13000

Seeding Relief for Transfer to ACSs and Relevant Offshore Funds

Seeding relief

When an insurance company transfers an asset to a UK ACS co-ownership fund, or an offshore transparent fund that create rights in the nature of co-ownership, in exchange for an issue of units to the insurance company, TCGA1992/S211B will apply.
The insurance company will be treated as having disposed of the asset to the fund on the basis that neither a gain nor loss will accrue to the company if, immediately before the asset was transferred, the asset was held for the purposes of the insurance company's long-term business and immediately after the transfer the asset is held in the same category as the original asset i.e. it is not a 'box' transfer LAM13210.

The units that the life insurance company will receive from the fund are treated as having been acquired for a consideration equal to the amount of consideration used to arrive at the no gain no loss position.

Anti-avoidance rules

Anti-avoidance rules are built into TCGA1992/S213 to prevent a life company seeding an asset into a fund immediately prior to disposal and taking advantage of the 7 year spreading of gains.

The rule applies where, within three years after the end of the accounting period in which the original S211B transfer occurred, there is a disposal or part disposal of the units received in respect of that transfer. In that case TCGA1992/S213(4)ZB-(4(ZC) treats the gain that would otherwise be spread over later years as accruing in the year of disposal.

For disposals before 1 January 2018, S213(4ZD) and (4ZE) provide that, in applying these rules to relevant offshore funds, the meaning of relevant offshore fund within TCGA1992/S103A will apply. For disposals after 1 January 2018 the definition in SI2009/3001/regulation11 will apply.

Further guidance on the tax treatment of participants in ACSs can be found in the Authorised Contractual Schemes Manual.

Transfers to managers of authorised investment funds

The buying and selling of units in authorised investment funds is normally transacted through the relevant authorised manager of the fund. Often life insurers will have their own 'in-house' fund manager responsible for many of the AIFs and therefore the connected party rules TCGA1992/18(3) may apply.

Relief is provided in TCGA1992/S210C, which dis-applies the connected party rules and prevents these losses becoming of more limited use. Losses arising from disposals of AIFs to the manager of the fund, as defined for S210C, can be set against chargeable gains under the normal rules of TCGA 1992.

S210C defines the manager as:

- in the case of an AUT, the person who is the manager for the purposes of FSMA 2000

- in the case of an OEIC, a director or other person having responsibility for management of the scheme property
- in the case of an authorised contractual scheme which is a co-ownership scheme, the person who is the operator of the scheme for the purposes of FSMA2000

These are formal appointments required by regulation.

LAM03400: Step 2 FA2012/S75: Allowable Capital Losses that are not BLAGAB allowable losses: FA2012/S95; TCGA1992/210A

General

BLAGAB chargeable gains, including spread deemed disposal gains (net of any S212 losses) can be reduced by BLAGAB allowable losses and, to a limited extent, by the shareholder's share of 'non-BLAGAB' allowable losses.

FA2012/S95 enables allowable capital losses which are not BLAGAB allowable losses, to be set against the shareholder's share (if any) of BLAGAB chargeable gains as determined under TCGA1992/S210A. This in turn will reduce the I-E profit for the period but it cannot be reduced below zero.

Before deducting any 'non-BLAGAB losses' the company must firstly deduct:

- any BLAGAB allowable losses that accrue to the company in the accounting period from disposal of assets held for the purposes of the long-term business
- any BLAGAB allowable losses brought forward from a previous accounting period.

The order of set off is dictated by the legislation:

- steps 1 and 2 of FA2012/S75 provide for the calculation of BLAGAB chargeable gains of the company for the accounting period as adjusted for allowable losses. For the purposes of the S75 calculation the allowable losses are current year and brought forward BLAGAB allowable losses
- the result of Steps 1 and 2 of FA2012/S75 is then taken to Step 2 of the I-E calculation (FA2012/S73)
- the I-E result at Step 6 of FA2012/S73 is then subject to FA2012/S95 (non-BLAGAB allowable losses)

So non-BLAGAB losses are brought into the computation at the final Step (6) of the I-E calculation, after utilising any current year and brought forward BLAGAB losses at Step 2.

The intended order of set off is also clear from the wording of FA2012/S95 (non-BLAGAB allowable losses): S95(1): *'This section applies if an insurance company has an I-E profit for an accounting period'*. In calculating whether or not the company has an I-E profit, Step 2 of FA2012/S73 takes into account only current year and brought forward BLAGAB allowable losses. FA2012/S95(3) makes it clear that 'non-BLAGAB' allowable losses are to be ignored in the S73 Step 2 profit calculation.

If a non-BLAGAB loss is only partly utilised against the shareholder's share of BLAGAB gains, the remaining loss is carried forward as a non-BLAGAB loss.

The method used to calculate the allowable set off is detailed at s210A(10A)-(10C). Note that the calculation of the I-E profit, for the purposes of establishing the shareholders' share under

s210A(10A)(a) and (b), excludes the impact of the 'non-BLAGAB loss' (i.e allowable losses that are not BLAGAB). In effect, this is a shadow calculation of the I-E profit, purely for the purposes of quantifying the s210A claim.

LAM03410: Step 2: Calculating the shareholder's share of BLAGAB gains S210A(2)

If the company has an I-E profit for the accounting period, the shareholder share is determined by TCGA1992/S210A(10):

- find the percentage of that I-E profit that is not represented by the policyholder share in accordance with FA2012/S103 (determines the policyholder's share of I-E profit)
- then multiply that percentage by the amount of BLAGAB chargeable gains

See LAM06020 for full details of the FA2012/S103 calculation.

Note that in computing the shareholder's share of chargeable gains S210A(11) provides that the calculation for the period ignores:

- S212(3) losses carried back (deemed disposals of unit trusts)
- a non-trading deficit carried back under CTA2009/ S389

Applying this formula to an example:

Assume company A has a shareholders share of 87% determined under FA2012/S103, an I-E profit of £160m, BLAGAB chargeable gains of £400m, current year allowable losses of £5m and brought forward allowable losses of £5m – net £390m. 'Non-BLAGAB' allowable losses are £200m.

6. Applying 87% to the BLAGAB net chargeable gains for the current period of £390m results in shareholders share of BLAGAB chargeable gains of £339m. In this example, the allowable losses that are not BLAGAB allowable losses ('Non-BLAGAB' allowable losses) can potentially be set against the shareholder share of chargeable gains up to a total of £339m.
7.
8. However, S95(2) allows the I-E profit to be reduced to nil, but no further. So in this example the maximum non-BLAGAB loss that can be utilised is £160m, reducing the I-E profit to nil. The unused non-BLAGAB allowable loss of £40m will be carried forward as a 'non-BLAGAB' allowable loss.
9.
10. With the figures in the example, there will not be a minimum profits charge notwithstanding that there is a policyholder share of profit before the offset of 'non-BLAGAB' allowable losses. LAM07320

LAM03420: Calculating the shareholder's share of BLAGAB losses: S210A(6)-(9)

11. TCGA1992/S210A also provides for the situation where there are BLAGAB allowable losses and net non-BLAGAB gains after deducting current year and brought forward non-BLAGAB losses.

12. The deduction is limited to the 'permitted amount' of BLAGAB allowable losses:

- S210A(6)(a) the shareholders share of losses after deduction of current period shareholders share of gains, plus
- S210A((6)(b),(7)(a) the shareholders share of losses from previous periods that are not already offset against the shareholder share of gains; reduced by
  - S210A(8) where current year BLAGAB gains exceed BLAGAB allowable losses, the brought forward amount is reduced by the proportion of brought forward allowable losses over total chargeable gains for the current period:

S210A(6) contains provisions dealing with the first accounting period where FA2012 took effect. The summary above relates to subsequent periods.

Assume in the example above there are net BLAGAB allowable losses of £390m in the current year and carried forward unrelieved shareholders share of BLAGAB allowable losses of £200m.

The shareholders share in the example LAM03410 above is 87%, so there is £339m loss. In addition the brought forward of £200m is available and there is a total of £539m of shareholders share of BLAGAB allowable losses to offset against any chargeable gains arising elsewhere in the company. There are provisions ensuring that non-BLAGAB allowable losses are used first, in priority to BLAGAB allowable losses.

It would be possible to use these shareholder losses against assets deemed to be transferred to the company under the provisions of S171A and S171C.

LAM03430: Unrelieved General Annuity Business (GAB) Losses

Under FA1991/Sch7/para17 BLAGAB chargeable gains may be reduced by former GAB Case VI losses. The legislation specifies the 'relevant part' of the companies chargeable gains against which GAB losses can be offset by reference to the mean of opening and closing liabilities on 'old annuity contracts'. GAB losses do not arise under the current life tax regime and hence consideration of brought forward balances in the few cases where these may still exist is all that is required.

LAM03500: Step 3 FA2012/S73 Calculate deemed 'I-E' receipts FA2012/S92

Certain BLAGAB trading receipts count as deemed I-E receipts and must be included in step 3 of the I-E basis calculation. These are receipts that are taken into account in calculating a BLAGAB trade profit or loss, but are not brought into the charge to corporation tax elsewhere and are not "excluded receipts".

The following are "excluded receipts"

- premiums
- sums received under reinsurance contracts unless it's a reinsurance commission, or it is a sum calculated by reference to the ordinary BLAGAB management expenses (as defined by FA2012/S77) of the company for the accounting period.
- sums which do not fall within the charge to CT because of an exemption (e.g. non-taxable distributions).
- payments received under the Financial Services Compensation Scheme.
- payments received from other insurance companies to enable the company to meet its obligations to policyholders

Examples of deemed I-E receipts, i.e. items that fall to be taxed under this rule, include reinsurance commissions, refunds of expenses, underwriting commissions and unit trust rebates. Any receipts in respect of qualifying R&D expenditure is treated as a deemed I-E receipt under CTA2009/104V(3).

The "appropriate amount" of receipts to be included at step 3 of the I-E basis calculation is calculated by deducting expenses from the receipts so far as is necessary to calculate the full amount of the profits.

LAM03510: Step 3 – Calculating 'I': FA2012/S93 minimum profits test and s94 adjustment - main treatment in LAM07170

The second part of the Step 3 calculation is the application of the minimum profits test at FA2012/S93. The purpose of the minimum profits test is to ensure that the taxable income of an insurance company under the I-E system is not lower than the BLAGAB trade profit for the period. The test identifies whether there is any I-E receipt to bring into charge or any expense to carry forward to the next accounting period.

The rationale behind the test is that all profit attributable to shareholders must be taxed. If adjusted profits under the I-E basis are lower than BLAGAB trade profits, the minimum profits test will adjust the I-E profit to at least the level of trade profits.

Further background and details of the calculation are set out in the trade profits chapter LAM07250

LAM03520: Step 4 – Calculating 'I': CTA2009/S388 deduction for non-trading deficits - main treatment in LAM03060

This final step in calculating 'I', deduction of BLAGAB loan relationship deficits is explained in LAM03060.

LAM03600: Chargeable gains from Venture Capital Limited Partnerships TCGA1992/Sch7AD: Overview

The practical difficulties in calculating chargeable gains arising to life insurance companies from their investments in venture capital limited partnerships were recognised by the Myner's Report (2001). Changes in ownership proportions, difficulties in valuation and delays in receiving information and deficiencies in information were all contributory factors.

Following the recommendations in this review, TCGA1992/SCH7AD (for periods of account beginning on or after 1 January 2002) was enacted to simplify the chargeable gains rules for life companies investing in venture capital limited partnerships. If certain conditions are met, the partnership can effectively be treated as a single asset.

Instead of treating the partners as holding a proportionate share of each of the shares and securities of the partnership the company must treat its interest in the 'relevant assets' of the partnership as a single asset, acquired when it became a partner – *paragraph 3 Schedule 7AD*. The 'relevant assets' of the partnership are the shares and securities, other than qualifying corporate bonds (QCBs) held by the partnership. QCBs are excluded because they would not be chargeable assets if the normal rules applied.

The qualifying conditions for TCGA1992/SCH7AD are written widely so it should apply to most life companies' investments in venture capital limited partnerships.

Schedule 7AD does not impose a liability on the partnership i.e. the liability to capital gains tax on the asset remains that of the partner, preserving the fiscal transparency of the partnership.

If these conditions are not met then the partnership chargeable gains rules will continue to apply with life companies being taxable on their share of chargeable gains (or losses) on their share of the underlying partnership assets.

The following sections cover:

- LAM03610 The single asset's acquisition cost
- LAM03620 Disposals
- LAM03630 Deemed disposals: computational rules for part-disposals with examples
- LAM03640 The scope of the rules and qualifying conditions
- LAM03650 Interaction with other legislation

LAM03610: Chargeable gains from Venture Capital Limited Partnerships TCGA1992/Sch7AD: Acquisition cost of the deemed single asset

If the partnership does not invest in any Qualifying Corporate Bonds 'QCBs' then the acquisition cost of the single asset is simply the amount of capital contributed by the company on becoming a member of the partnership – *paragraph 4(1) Schedule 7AD*.

Where the investments of the partnership include QCBs, the acquisition cost is reduced by the fraction:-

(A-B)/A,

Where:

A is the book value of all shares and securities held by the partnership at the end of the partnership accounting period in which the contribution is fully invested

B is the book value of the QCBs held by the partnership at the end of that period – paragraph 4(4) Schedule 7AD.

Making the test apply for the period in which the contribution is fully invested avoids anomalies if, for instance, the contribution was not invested until a later period. In practice, there is not usually a problem in identifying the period in which the contribution is fully invested as contributions from partners are normally invested fairly soon after they are made.

Any further contributions of capital are also treated as acquisition cost, subject again to the pro-rata reduction in respect of QCBs – *paragraph 4(2) Schedule 7AD*.

Meaning of "book value" and "accounts"

"Book value" is the value shown in the partnership's accounts at the end of the period of account. "Accounts" are accounts drawn up in accordance with generally accepted accountancy practice – *paragraph 10(2) Schedule 7AD*.

If no such accounts have been drawn up then the values to be taken are what would have appeared in such accounts, if they had been drawn up.

Contributions of capital by the company to the partnership

Contributions of capital include certain interest-free loans which are required to be made by all the limited partners, and which are accounted for as partners' capital or partners' equity in the accounts of the partnership – *paragraph 10(3) Schedule 7AD*.

This recognises the commercial reality that a substantial amount of what is essentially capital funding is made by the investing limited partners in this way. Some limited partners (such as founder partners) may not make contributions by way of interest-free loans because they are not investing partners. In such circumstances we would regard the requirement that all limited partners make interest free loans as met.

LAM03620: Chargeable gains from Venture Capital Limited Partnerships TCGA1992/Sch7AD: Disposals

Disposals by the company of its interest in the partnership

Where Schedule 7AD applies, the insurance company's interest in the relevant assets of the partnership is treated as a single asset. If the company disposes of all or part of its interest in the partnership then this is a disposal of the single asset. The normal capital gains rules apply to that single asset, including the apportionment rule in TCGA1992/S52(4) and the connected party rules.

Where the partnership disposes of assets that are not relevant assets, the standard partnership rules apply as set out in TCGA1992/S59, extended to cover limited liability partnerships by S59A. Statement of Practice D12, setting out practical aspects of calculating partnership gains, also applies.

Deemed disposals of the single asset in case of distributions

Just as there is an acquisition or enhancement of the deemed single asset when the company contributes capital to the partnership, there is a deemed disposal or part-disposal of the single asset when the company receives a distribution from the partnership which includes proceeds from the sale or redemption of the relevant assets– *paragraph 5 Schedule 7AD*.

The consideration received for this disposal is simply that part of the distribution not consisting of income or proceeds from the sale or redemption of QCBs. This information should be readily available.

Deemed disposals: excessive delay in distributing proceeds

There is an anti-avoidance provision in paragraph 5(3) Schedule 7AD which applies if the partnership does not distribute the proceeds from the sale of chargeable assets within 12 months of the sale.

Then, the company is treated as receiving the proceeds of the sale at the later of

- the end of the partnership's accounting period following that in which the disposal occurred and
- 6 months after disposal.

When the distribution is actually made, paragraph 5(5) ensures that a further chargeable gain or loss does not arise on the same disposal of partnership assets.

LAM03630: Chargeable gains from Venture Capital Limited Partnerships TCGA1992/Sch7AD: Deemed disposals: computational rules for part-disposals

Unless the partnership is disposing of the last of its relevant assets, any distributions will give rise to a part-disposal of the single asset. The normal part-disposal rule in TCGA1992/S42 apply. However, as it would be hard to establish the market value (MV) of the property remaining after the disposal TCGA1992/SCH7AD/PARA6 sets out how MV is determined.

Where there has been a single distribution in the period:-

$$\text{Cost} = \text{Total cost} \times \frac{\text{Distribution received}}{\text{MV}}$$

Where:

MV = Distribution + book value of the relevant assets

If there has been one or more disposals after the part-disposal in question in the same accounting period of the partnership, then the further distributions received are added to the MV in the calculation above.

Deemed disposals: – part-disposal example

In period of account of partnership y/e 31/12/2017, Insurance co X has a 50% interest in a qualifying investment partnership VP LLC for which it contributed capital of £3,000.

VP LLC holds the following assets with book values at 31.12.16:

Asset	Value
Shares in (unquoted) A Ltd	£5,000
Shares in (unquoted) B Ltd	£2,500
Shares in (unquoted) C Ltd	£2,500
QCBs issued by D Ltd	£5,000

Relevant assets = £10,000

Total assets = £15,000

Cost of the single asset = £3,000 x ((£15,000 - 5,000)/£15,000) = £2,000

In the period VP LLC disposes of its shares in A Ltd and makes two distributions

First Distribution = £300, of which £20 represented income =>proceeds =£280
Second distribution = £700, of which £40 represented income =>proceeds =£660

The value of the part retained at 31/12/17 is £5,000 i.e. company's share of value of shares and non-QCBs in books of partnership at 31/12/2017.

Part disposal 1 calculation (ignoring indexation): There is a further disposal in the same accounting period so paragraph 6(3) applies.

Cost = £2,000 x (£280/(£280 + £660 + £5,000)) = £94.20

Gain = £280 - £94.20 = £185.80

Part disposal 2 calculation (ignoring indexation): There is no further disposal in the period so paragraph 6(2) applies and 'B' is simply £5,000.

Cost = (£2,000 – £94.20) x (£660/(£660 + £5,000)) = £222.22

Gain = £660 - £222.22 = £437.78

Total gain on both part-disposals £185.80 + £437.78 = £623.58.
The remaining base cost (ignoring indexation) is £2,000 less (94.2+£222.2) = £1,683.60

LAM03640: Chargeable gains from Venture Capital Limited Partnerships TCGA1992/Sch7AD: Scope and Conditions of Schedule 7AD

Scope

The Schedule applies to insurance companies holding assets as a limited partner in a "venture capital investment partnership" (VCIP) Schedule7AD/PARA2. "Limited partner" is widely defined in PARA10(1) and likely to be met in most cases:

- For UK partnerships, the company is carrying on business as a limited partner in a partnership registered under the Limited Partnership Act of 1907.

- For foreign partnerships, the life company is carrying on business jointly with others, and, under the laws of the country or territory concerned, not entitled to take part in the management of the business and not liable beyond a certain limit for debts and obligations incurred for the purposes of the business.

  A company is not regarded as taking part in the management of the business purely because it is represented on a committee advising on investment decisions.

  Limited partners in partnerships formed under the laws of the following countries or territories, which are common partnership locations, would be expected to qualify:

  - Ireland
  - Jersey
  - Guernsey
  - Isle of Man
  - Delaware (and any other US state or territory adopting the Uniform Limited Partnership Act)

The rules apply for periods of account beginning on or after 1 January 2002 including straddling periods. There was an option to elect *paragraph 11 Schedule 7AD* to dis-apply these rules for straddling periods and for investments where the company made its first contribution of capital to the partnership before 17th April 2002 (Budget Day). Where an election has been made to 'opt out', the normal partnership disposal rules would apply.

These changes in 2002 may still be relevant where assets are still held currently and an election was made previously under these provisions. The elections must have been by notice to an officer of the Board not later than 2 years after the end of the life company's first accounting period beginning on or after 1st January 2002 – *paragraph 13 Schedule 7AD.*

Conditions to be a qualifying partnership

Paragraph 2 Schedule 7AD sets out the conditions to be met by the partnership to be a VCIP. These are:

i. the sole or main purpose of the partnership is to invest in unquoted shares or securities as evidenced from the partnership agreement or the prospectus issued to prospective partners

ii. the partnership does not carry on a trade

iii. not less than 90% of the book value of the partnership's investments at the end of the partnership accounting period is attributable to investments that are either

   - shares or securities that were unquoted at the time of their acquisition by the partnership, or
   - shares quoted at time of acquisition but which it was reasonable to believe would cease to be quoted within the next twelve months.

     This allows the partnership to invest in listed companies which are intended to be de-listed, so-called 'public to private transactions'

Holdings of cash or quoted shares and securities by the partnership

In determining whether the third condition – *paragraph 2(4) Schedule 7AD* – is met, holdings of cash (including held in deposit or similar accounts) are disregarded unless acquired wholly or partly for the purpose of realising a gain on its disposal. Holdings of quoted shares or securities are also disregarded if they were acquired in exchange for unquoted shares or securities. 'Quoted' has the usual meaning i.e. listed on a recognised stock exchange.

'Fund of funds' investments by partnership

Venture capital partnerships, especially those in the USA, often invest in other venture capital partnerships rather than directly in the shares of target investments, a so called 'fund of funds' approach. Schedule 7AD/PARA9 treats investments by a VCIP by way of capital contribution to another VCIP as an investment in unquoted shares and securities. This allows the conditions in PARA2 to be met in these circumstances.

PARA9(2) contains a power to set out in regulations the precise way that such investments are to be taken into account by Schedule 7AD. Although attempts were made to agree with the industry an approach for the regulations to take, it was found impossible to cater easily for cases, which are common, where there are more than two layers of partnerships. In cases where there are funds of funds HMRC may agree a reasonable approach to the calculation of gains, following the Schedule 7AD approach as far as possible.

In some cases, the first level partnership may be treated as an opaque vehicle for income purposes, for example treating the investments of the first level partnership as if they were loan relationships and simply following the accounts charging all profits as income. This may be particularly appropriate in the case of US partnerships, where the only information available to the insurance company is that in the US tax return K1. Any agreements of this sort should be referred to the insurance policy team.

Partnerships ceasing to qualify

The requirement for the qualifying conditions to be met is ongoing. If the partnership ceases to meet the conditions for any accounting period then the life company will revert to the normal rules from the start of the accounting period of the partnership following that in which the partnership ceased to qualify- paragraph 2(6) Schedule 7AD. There are no special rules for transition back to the normal rules.

A partnership that ceases to meet those conditions cannot qualify again as a venture capital investment partnership- paragraph 2(7) Schedule 7AD. This avoids potential practical difficulties in moving from one basis of calculation to another in line with the aim of simplification.

LAM03650: Chargeable gains from Venture Capital Limited Partnerships TCGA1992/Sch7AD: Interaction with other legislation

Interaction with offshore funds legislation

The provisions of the offshore fund rules are specifically stated to apply regardless of the application of Sch7AD. In particular, the company's interest in an overseas VCIP is not treated as a material interest in an offshore fund - Sch7AD/para7(1). This allows the offshore fund rules to apply, where relevant, if the partnership holds a material interest in an offshore fund. Further details are in the Offshore Funds Manual.

If an offshore income gain arises and a distribution is made, para7(2) prevents any double taxation. The disposal consideration for Schedule 7AD purposes is reduced by the amount of the whole or corresponding part of the offshore income gain.

Interaction with other legislation

If a VCIP holds more than 50% of a company's shares, that company is likely to be a close company, or would be close if UK resident. This is because if there is at least one partner which is not a non-close company (such as an individual or pension scheme), CTA2010/S448(1)(a) will have the effect of giving to such a partner all the rights and powers of all the other partners.

In these circumstances, TCGA1992/S13 could apply where wholly artificial arrangements were put in place as part of a tax avoidance scheme or arrangements with the purpose or one of the main purposes of avoiding UK Capital Gains Tax or Corporation Tax (the test under TCGA92/S13(5)(cb)). If this is the case then these UK residents can be assessed to Capital Gains Tax or Corporation Tax on chargeable gains on a proportionate share of the company's capital gains. See CG57200 onwards for further details. Such gains accrue separately from the provisions of Schedule 7AD. In practice, the partnership arrangements are aiming to achieve tax neutrality – each partner is taxed according to their own tax status / residence. As a result these rules would not normally be expected to apply and any cases should be referred to policy.

The substantial shareholdings exemption in TCGA1992/Schedule 7AC does not apply in a case where Schedule 7AD applies, even if the life company would be regarded as having a substantial enough holding in the company disposed of had it invested directly rather than through the partnership. This is because the gain on the shares does not accrue to the partner, it is the gain on the "single asset" that accrues to it, and the single asset is not a substantial shareholding.

The interest in relevant assets of the partnership is treated as a single asset and the company cannot also make a negligible value claim under TCGA1992/S24(2) in respect of any of the underlying assets in the partnership.

LAM03700: Transactions in shares: share exchanges (where SSE does not apply)

Where a life insurance company holds shares in a company A for the purposes of the life company's long-term business, and transfers these to another group company B in exchange for shares in company B, TCGA1992/S127 applies as a result of TCGA1992/S135. The effect of that is that the life company is not treated as disposing of its shares in A, but as having acquired the shares in B when it acquired the shares in A and for the cost of those shares.

As TCGA92/S127 applies, S171(3) disapplies S171. Therefore, even though the shares in A cease to be held for the purposes of the life company's long-term business, FA2012/S118(6) does not apply to deem there to be a disposal which would otherwise be subject to the connected party rules in TCGA92/S17 and S18 and therefore deemed to be at market value.

See LAM03730 on the interaction of the share exchange and the substantial shareholding rules.

LAM03710: Transactions in shares: Bed & Breakfasting: TCGA1992/210B

General

Capital gains tax 'bed and breakfasting' 'B&B' anti-avoidance rules aim to limit the ability of investors to artificially create losses by selling and immediately or almost immediately, buying them back.

The B&B rules are explained in the Capital gains tax manual and are adapted to cater for the way box transfers worked for life companies in S210B. In particular, a 'disposal' for this purpose includes FA2012/S116 "box" transfers.

Without this adaptation, life companies could artificially generate BLAGAB capital losses by 'transferring' assets between CGT boxes within the life company.

Operation of the B&B rules

TCGA1992/S210B(5) applies when:

- there is a disposal of securities that are a chargeable S119 or S120 holding
- there is an acquisition of securities within any 10 day period including the disposal date that increases the same holding
- absent this section a loss would arise
- the disposal and acquisition are not on the same day (as S105 would apply)

In this case the acquisitions and disposals in the 10 day period are matched. In practice this can be 18 days – the nine days before and after the disposal. In order to determine if a loss would be made the operation of these rules are aligned with B&B rules for other capital gains - set out with an example in the Capital gains tax manual.

Identification and ordering rules S210B

If TCGA1992/S210B(1) applies, then S210B(2) requires the shares disposed of to be identified in a slightly different way from the standard B&B rules. , The ordering rule for identification in S210B(3)-(4) in the 10 day period before and after the disposal is:

- first identify the disposal with acquisitions on the same day – S105(1) applies to these – *S210B(5)*;
- then identify securities acquired **before** the disposal; and for these identify securities acquired later than those acquired earlier (LIFO basis);
- then identify securities acquired *after* the disposal; and, for these identify securities acquired earlier than those acquired later (FIFO basis).

Where there is more than one disposal, acquisitions will be identified in a similar way, with disposals at an earlier date in preference to disposals at a later date.

The differences from the standard B&B rules in S107 are:

a) if the nine days before the disposal contain a relevant acquisition, S210B identifies the disposal with a later acquisition before an earlier, while S107 does the opposite.
b) after identifying the disposal with the acquisitions in the previous nine days, the normal rules would proceed immediately to the pools. But S210B requires the examination of acquisitions in the nine days following the disposal.

Other differences: Exceptions

Specific exceptions from the B&B rules exclude the following:

- collective investment scheme holdings within TCGA1992/S212(1), whether a deemed disposal or an actual disposal – *S210B(6)(a).*
- assets wholly matched to BLAGAB liabilities where the assets are appropriated to a BLAGAB internal linked fund, and are disposed of and reacquired in order to match liabilities of that or another such fund - S210B(7).

These are cases where a company may have little or no choice about the disposal, or where it is unlikely that significant losses could be generated.

LAM03720: Transaction in shares: "substantial shareholdings exemption" "SSE" TCGA1992/Sch7AC

Background and summary

Since April 2002, most corporate sales of trading companies where the holding exceeds 10% have been entitled to the Substantial Shareholdings Exemption (SSE). The policy aim was to take out of the tax charge assets that were not part of an investment portfolio or trading operation and more in the nature of structural business assets. (To be updated for Finance Bill (no.2) 2017)

The SSE provisions in TCGA1992/192A & Sch7AC are explained in the capital gains tax manual.

Specific rules were developed for life companies to reflect the fact that, although they have investment portfolios taxable as capital gains in BLAGAB, they may have holdings in excess of 10%. These may still be portfolio investments and should not therefore benefit from the exemption. In practical terms, it will also limit the number of potential claims for SSE. A life insurer could also have assets that are long-term business fixed capital (LTBFC), such as structural assets, which may be within the capital gains regime such that SSE could apply.

The principal differences in the rules for life companies are:

1. for assets backing long-term insurance business the qualifying threshold for a holding is 30% not 10% Sch7AC/Para17(1)

2. the 30% can include holdings not backing long-term business for tax purposes e.g. LTBFC, general insurance business Para17(2)

3. Long-term business assets are ring fenced from any calculation of the group holding for SSE purposes PARA9(2)/para 17(4)

4. The 30% limit also applies to disposals by 51% subsidiaries of the life company if held directly or indirectly for purposes of long-term business para 17(3)

5. The SSE does not apply to a 'box transfer' between categories within the life company Sch7AC/Para6(1)(c)

6. SSE can apply to a transfer from a life company to another group company – see below for further explanation of interaction between share exchange rules, SSE and box transfer rules.

7. Gains on derivatives and options over shares are also subject to special rules when held by life companies, including the 30% holding applying.

Points 1-5 are covered in the examples below. Further details on points 6 and 7 are explained further in LAM03730 and LAM03740.

SSE Examples: Holdings backing long-term business and held as LTBFC within the life company

Example 1

Holding	%	SSE applies?
Long-term business holding	15%	No overall holding < 30%
LTBFC/general insurance business holding	8%	Yes, can take account of long-term business holding so total holding > 10%

If the 8% holding was instead in another group company, it could not take into account the life company holding to reach the 10% threshold.

SSE Example 2

Holding	%	SSE applies?
Long-term business holding	25%	Yes, overall holding in the company > 30%
LTBFC/general insurance business holding	12%	Yes, holding > 10% with or without long-term business holding

In example 2, if the 12% was held in another group company, it could not be taken into account by the life company in calculating the 30% threshold.

LAM03730: Substantial shareholdings exemption, "SSE" The interaction of the SSE rules and other life tax rules

"Substantial shareholdings": interaction with 'Box Transfers'

The SSE exemption in Schedule 7AC does not apply where there is a deemed disposal on the transfer of an asset of an insurance company from one category to another (a 'box transfer') under FA2012/S116 to S118 (See LAM13210) – paragraph 6(1)(c) Schedule 7AC. Schedule 7AC can apply where there is a transfer out of, or into, the long-term insurance business 'boxes' to or from another group company. Paragraph 6(1) does not exclude such a disposal. It is not a no gain/no loss disposal because S118(6) disapplies TCGA1992/S171, and so it is not within paragraph 6(1)(a)Sch 7AC. As it is an actual, rather than a deemed, disposal, it is not within paragraph 6(1)(c).

Gains from Shares: "substantial shareholdings": interaction with share exchange rules

Special rules apply to give the SSE priority over other capital gains rules including the share exchange rules at TCGA1992/S127 (TCGA1992/Sch7AC/para4(1)(b)). In the case discussed in LAM 03700 a share exchange, between boxes within the long-term insurance fund does not trigger a disposal under FA2012/S116 to 118. Given this, we need to consider whether SSE can apply to share disposal by a life company within its long-term fund to another group company, in exchange for group company's shares.

The interaction of the rules is complicated and is best illustrated by considering in a step by step manner.

Life Co transfers shares in company A to company B in exchange for an issue of shares in company B. All companies are part of a capital gains group.

1. TCGA1992/S127, is disregarded for SSE purposes. In line with the examples shown at CG53170A we will call this disposal 'the assumed disposal';

2. the assumed disposal is found to be an intra-group disposal to which TCGA1992/S171 could apply, because on the basis of the assumption that there is a disposal (as S127 is disregarded), TCGA92/S171(3) will not have effect to switch off TCGA92/S171(1);

3. however, FA2012/S118(6) would disapply TCGA1992/S171;

4. as the shares are no longer backing long-term business and moving to another group company Schedule 7AC could apply. This is because the transfer is not a no gain/no loss disposal – *paragraph 6(1)(a)* – nor a deemed disposal falling within paragraph 6(1)(c).

5. if this disposal produces a gain or loss within the SSE rules TCGA92/Sch7AC/para 4(3) applies to prevent TCGA92/S127 from applying.

The result would be that Life Co makes a disposal of this holding of shares in company A for consideration equal to the value of the shares issued by company B – any gain or loss arising on the disposal is, by virtue of the SSE, not a chargeable gain or allowable loss; company B acquires the shares in company A at the value of the shares it issued to Life Co; and Life Co acquires the newly issued shares in company B at the amount or value of the consideration (the shares in B) given for them.

LAM03740: Substantial shareholdings exemption, "SSE" and Gains on Loan Relationships and Derivative Contracts

Gains from convertibles: "substantial shareholdings": special rules for life insurance

companies

Where CTA2009/PART7/s 645 (convertible loans) applies to an asset, any chargeable gain is exempt under the SSE – *S642* (see CFM55030).This is on condition that the holding of ordinary shares in the company into whose shares the asset is convertible, or for whose shares the security is exchangeable, amounts to at least 30% - TCGA1992/Sch7AC/para17(2). See LAM03720 for further information about SSE.

Derivatives and the substantial shareholdings exemption

Derivative contracts and options over shares: SSE

TCGA1992/Sch7AC contains an exemption from corporation tax on chargeable gains (and so prevents allowable losses) accruing to a company on the disposal of assets related to shares. These include: securities that can be converted into or exchanged for shares; or an option to acquire or dispose of shares (see CG53010).

Where an option or security is disposed that is held for the purposes of the company's long-term insurance business, any gain is only exempt if the holding amounts to at least 30% – *paragraph 17(2) Schedule 7AC*. It is immaterial whether the 30% is held to back long-term business or outside it, or both. See examples in LAM03720.

LAM04000: Calculating 'E' – 'adjusted BLAGAB management expenses' FA2012/76

LAM04010	Calculating 'E': "adjusted BLAGAB management expenses": FA2012/S76
LAM04020	Calculating 'E': Step 1: 'ordinary BLAGAB management expenses' Definition – conditions and excluded amounts: FA2102/S77
LAM04030	Calculating 'E': Step 1: amounts treated as ordinary BLAGAB management expenses: FA2012/S81
LAM04040	Calculating 'E': Step 1: restrictions on unpaid remuneration, car hire and FOTRA related expenses: FA2012/S82 and FA2012/S96
LAM04100	Calculating 'E': Step 2: definition of acquisition expenses: FA2012/S80
LAM04110	Calculating 'E': Step 2: spreading of acquisition expenses: FA2012/S79
LAM04120	Calculating 'E': Step 2: Example - spreading of acquisition expenses: FA2012/S80
LAM04200	Calculating 'E': Step 3: Calculate the amount of any deemed management expenses: FA2012/S78(3)
LAM04210	Calculating 'E': Step 3: General Annuity Business: FA2012/S83
LAM04300	Calculating 'E': Step 4: Calculate the basic amount: FA2012/S76
LAM04400	Calculating 'E': Step 5: The adjusted BLAGAB management expense
LAM04500	Calculating 'E': Example steps 1 to 5 - 'adjusted BLAGAB management expenses': FA2012/S76

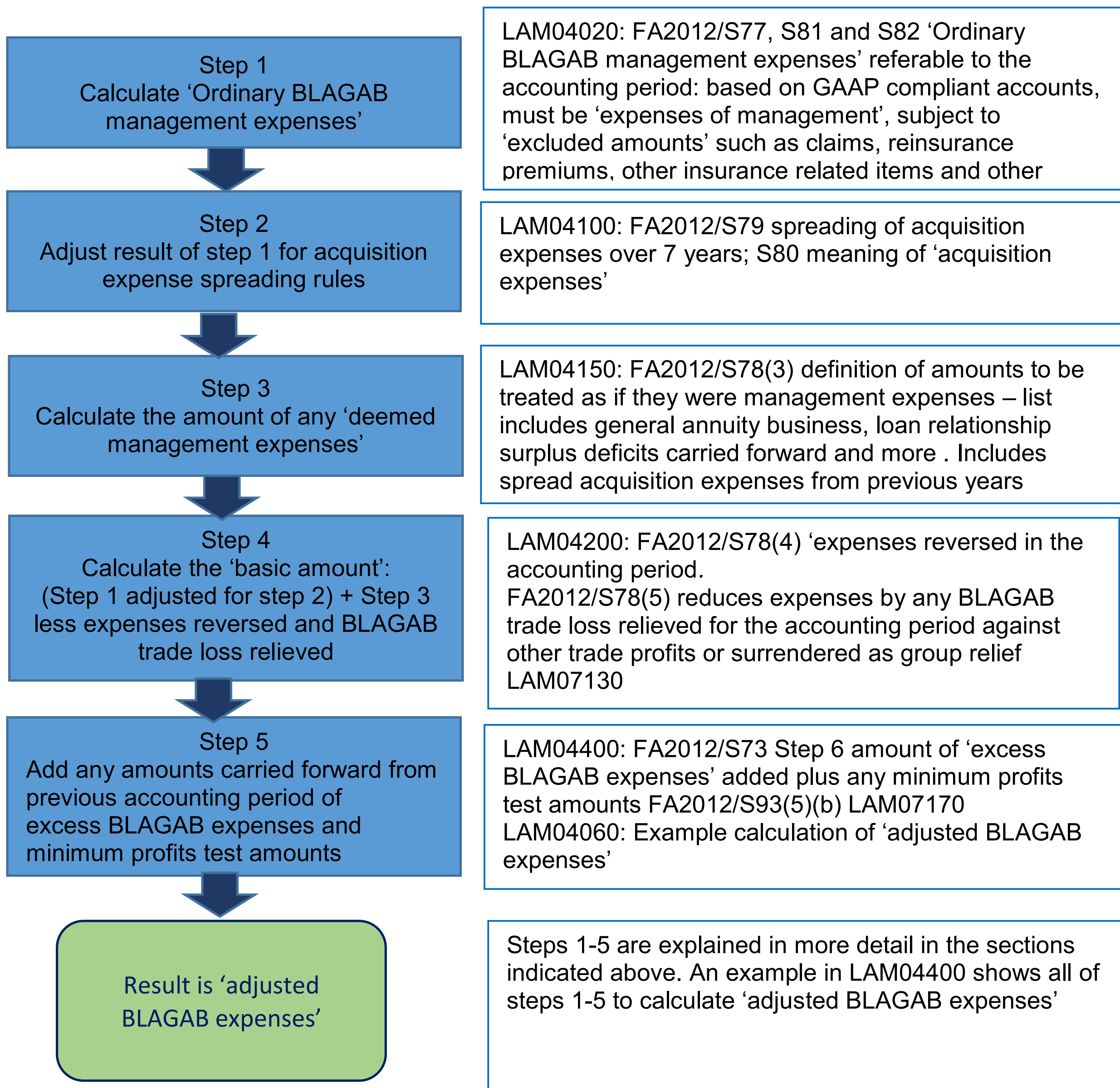
LAM04010: Calculating 'E': "adjusted BLAGAB management expenses": FA2012/S76

Introduction and overview

FA2012/S73 sets out how to calculate 'I-E profit' or 'excess BLAGAB expenses' for an accounting period. It provides for the "adjusted BLAGAB management expenses" to be deducted at Step 5

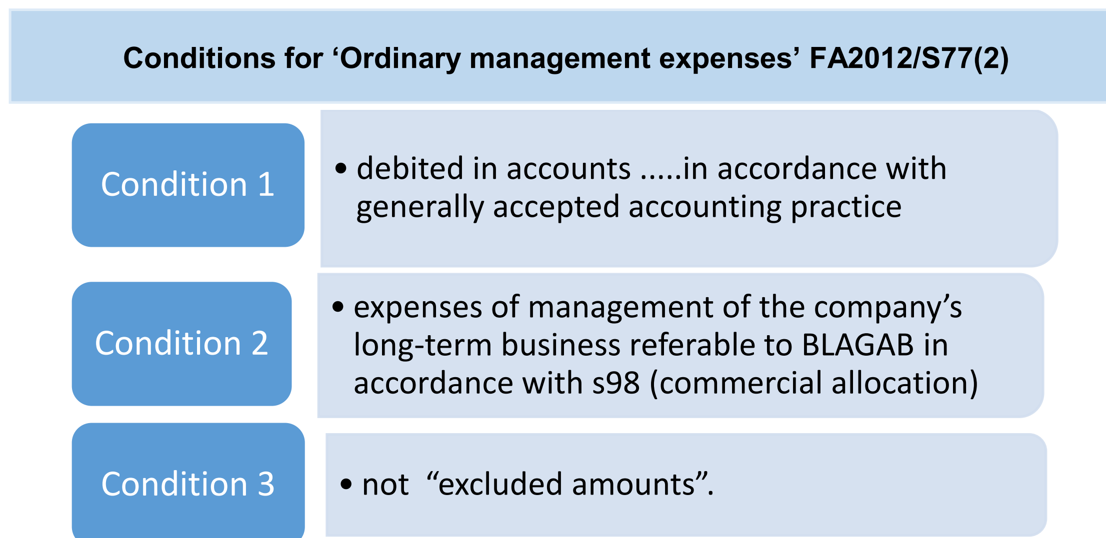
Expense deduction is broadly on a similar basis to management expenses but with some specific tailoring for BLAGAB. Insurance related expenses such as claims are excluded restricting the expenses to what are more broadly accounts based 'operational expenses'. This is subject to specific exclusions including adjustment for acquisition expenses which are spread over 7 years. These expenses are generally also spread in the accounts but the means of accounts spreading will vary between companies.

The steps for calculating adjusted BLAGAB management expenses are detailed in S76 and are summarised below:



LAM04020: Calculating 'E': Step 1: 'ordinary BLAGAB management expenses' Definition – conditions and excluded amounts: FA2012/S77

FA 2012/S77 defines ordinary BLAGAB management expenses referable to an accounting period. This definition is expanded in S81 and certain restrictions are introduced in S82.



Condition 1, which covers amounts debited in either the profit or loss account/income statement or the other comprehensive income statement is subject to FA2012/S77(3). Acquisition costs (see LAM04100) acquisition expenses (as defined for tax purposes) are ordinary management expenses of the accounting period in which they are incurred in the first period in which any part of them is debited in the accounts. Therefore, any spread amount in the accounts must be reversed out, before applying the spreading of acquisition expenses under the statutory rules.

Expenses must be referable to an accounting period. Expenses relating to a period of account coinciding with, or falling wholly within, an accounting period are all referable to that accounting period, unless there is a specific rule to the contrary. (FA2012/S77(8))

Expenses relating to a period of account which only partly coincides with an accounting period must be apportioned: only the amount apportioned to the accounting period on a time basis in accordance with CTA2010/S1172 is referable to the accounting period. (FA2012/S77(9))

Excluded amounts (FA2012/S77(4))

The following "excluded amounts" are not 'ordinary BLAGAB management expenses':

- amounts of a capital nature (this is the general rule but it may be overridden if express provision is made in the legislation)
- reinsurance premiums
- refunds of premiums
- profit commissions and profit participations (however described)
- commission or other expenses in excess of what a company could reasonably be expected to pay if it were chargeable to tax as a trade under s35 CTA 2009 and normal trading rules applied
- non-commercial amounts payable (amounts payable to the extent to which they are incurred for a purpose other than a business or other commercial purpose)

- amounts payable in connection with a policy or contract to a policyholder or annuitant or any other beneficiary under the policy or contract (including a deceased person who fell into those categories) and any person acting for such persons (including any deceased person who acted for such persons). But if an insurance company is a policyholder under a policy, any amounts payable to the company are not excluded amounts.

LAM04030: Calculating 'E': Step 1: amounts treated as ordinary BLAGAB management expenses: FA2012/S81

FA2012/S81 brings within ordinary BLAGAB management expenses certain expenses which would not otherwise be regarded as such. They must still meet the first two basic conditions set out in FA2012/S77(2) (see LAM04020), broadly being expenses debited in accordance with generally accepted accounting practice, which are referable to BLAGAB.

Several provisions of CTA 2009 which treat particular expenses as expenses of management in the case of companies with investment business are adopted as "relevant permissive rules". These expenses can then be treated as ordinary BLAGAB management expenses for the purposes of FA2012/S76. These all relate to expenses which are deductible expenses for companies generally.

The relevant CTA2009 provisions are as listed in S81(3) are:

- S1000 (costs of setting up employee share ownership trust
- S1234 (payments for restrictive undertakings)
- S1235 (employees seconded to charities and educational establishments)
- S1237 (counselling and other outplacement expenses)
- S1238(1) to (3) (retraining courses)
- S1239 to S1242 (redundancy payments and approved contractual payments), subject to a restriction where additional redundancy payments are regarded as FA2012/S79 acquisition expenses (FA2012/S81(5))
- S1243 (payments made by the Government)
- S1244 (contributions to local enterprise organisations or urban regeneration companies), subject to CTA2009/S1253 disqualifying benefit adjustment

Expenses in connection with contaminated or derelict land CTA2009/S1161-2

Land Remediation Relief (CIRD60000) was introduced to address market failure, in bringing back into use, land that had been blighted by previous use for industrial purposes. CTA2009/S1161/62 applies this relief to life insurance companies carrying on BLAGAB.

Where a company incurs qualifying land remediation expenditure (CTA2009/S1144) in respect of a major interest in UK land, it uses for management of BLAGAB business, or it intended for such use, the expenses can be treated as ordinary BLAGAB management expenses for the period.

The land must be acquired in a contaminated state or be in a derelict state throughout the period from acquisition, or 1 April 1998 if earlier.

CTA2009/S1162 provides additional relief as a deemed BLAGAB management expense in an amount equal to 50% of the BLAGAB management expenses relating to the qualifying land remediation expenditure, following a claim by the company.

No relief is available under CTA2009/S1161 or S1162 in respect of expenditure on land which is in a contaminated state as a result of anything done, or not done, by the company, or a connected person, or land in a contaminated or delict state as a result of anything done, or not done, by another person who has an interest in the land.

LAM04040: Calculating ‘E’: Step 1: restrictions on unpaid remuneration, car hire and FOTRA related expenses: FA2012/S82 and FA2012/S96

FA2012/S82 restricts the extent to which certain expenses which would otherwise be regarded as ordinary BLAGAB management expenses may be so treated for the purposes of FA2012/S76. The restriction is in line with that applying to companies more broadly on unpaid remuneration and expenses incurred in hiring a car.

Unpaid remuneration FA2012/S82(2): CTA2009/S1249-50

FA2012/S82(2) – (3) applies the rules in CTA2009/S1249-50 relating to unpaid remuneration to life insurance companies BLAGAB expenses, subject to any spreading required in FA2012/S79. Any remuneration charged in the accounts of a company for a period of account but not paid within 9 months of the end of the period of account is not admissible as an expense for that period of account for tax purposes. Instead it is treated as an expense of the period of account in which it is paid. If it is not paid it does not qualify as an expense.

Car Hire FA2012/S82(4) : CTA2009/S1251(1)

CTA2009/S1251 restricts by 15% the deduction an investment company can claim for expenses incurred on hiring a car in specific circumstances. The same restrictions are applied in the case of BLAGAB management expenses S82(4).

If there is a subsequent rebate of those charges and an amount would fall to be deducted as a reversed expense or taken into account in calculating an I-E receipt under FA2012/S92, the amount deductible or taken into account is also reduced by 15%. The same rule applies if a debt in respect of the hire charges is released otherwise than as part of a statutory insolvency arrangement.

Restriction of expenses referable to exempt FOTRA profits FA2012/S96: CTA2009/S1279

FA2012/S96 restricts ordinary BLAGAB management expenses for overseas life insurance companies to exclude any amounts relating to exempt FOTRA profits (CTA2009/S1279)
CTA2009/1279 exempts from corporation tax profits from FOTRA (free of tax to residents abroad) securities. Since they are not taxable as BLAGAB profits, it is appropriate that relief should not be given for related expenses in calculating BLAGAB management expenses. BLAGAB expenses are thus restricted in accordance with FA2012/S96. The proportion of ordinary BLAGAB management expenses referable to exempt FOTRA profits is ignored in the calculation required by Step 1 of the s76 calculation. That proportion is computed by multiplying the ordinary BLAGAB management expenses for the accounting period by the following fraction:
<u>the amount of exempt FOTRA profits</u>
the amount of I computed at Step 4 of FA2012/S73 plus the amount of exempt FOTRA profits.

The proportion of the management expenses that is effectively disallowed is calculated by applying a formula:

FOTRA/(FOTRA + I)

Where ‘FOTRA’ is the amount of exempt FOTRA profits of the accounting period and ‘I’ is the BLAGAB income and gains generated at Step 4 (FA2012/S73, LAM03000).

LAM04100: Calculating ‘E’: Step 2: definition of acquisition expenses: FA2012/S80

FA2012/S80 explains what is meant by “acquisition expenses”. These are:

- commissions (however described) other than commissions for persons who collect premiums from house to house
- any other expenses payable solely for the purpose of acquiring business, and
- where expenses are payable partly for the purpose of acquiring business and partly for other purposes, so much of those expenses as is properly attributable to acquiring business

For accounting purposes acquisition costs are defined in the glossary to FRS 103 'Insurance Contracts' as “costs arising from the conclusion of insurance contracts including direct costs and indirect costs connected with the processing of proposals and the issuing of policies”.

They are further defined in note 6 to the Notes on the Profit and Loss Account format in Schedule 3 to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008: acquisition costs

> “comprise the costs arising from the conclusion of insurance contracts. They must cover both direct costs, such as acquisition commissions or the cost of drawing up the insurance document or including the insurance contract in the portfolio, and indirect costs, such as advertising costs or the administrative expenses connected with the processing of proposals and the issuing of policies."

Since the definition of acquisition costs for accounting purposes and that of acquisition expenses for tax purposes are not identical, the acquisition costs shown in statutory accounts may not necessarily equate to acquisition expenses for tax purposes. One possible difference is that for tax purposes acquiring business includes not just acquiring completely new business but also securing increased or additional premiums or consideration in respect of existing business. Acquisition activity should normally be taken to continue up to the point at which a contract is finalised.

Acquisition costs in accounts are likely to be debited for more than one period of account, i.e. spread. The aim is to match the costs to the income which the business acquired generates. For tax purposes acquisition expenses (as defined for tax purposes) are ordinary management expenses of the accounting period in which they are incurred (FA2012/S77(3)). Therefore, any spread amount in the accounts must be reversed out. The total (tax defined) acquisition expenses incurred for an accounting period are then spread for tax purposes over seven years in accordance with the rules at FA2012/S79 (see LAM04110-04120).

LAM04110: Calculating ‘E’: Step 2: spreading of acquisition expenses: FA2012/S79

The income a company earns from long-term business acquired in year 1 will be received over a period of years, and companies are normally required, by accounting standards, to spread the cost of acquiring business over a period of years.

The S79 adjusted amount of acquisition expenses referable to an accounting period, is spread for tax purposes over seven years. This spreading for tax will differ from the accounting position.

The adjusted amount of acquisition expenses is calculated as follows:

- take acquisition expenses included at Step 1 of FA2012/S76
- deduct "any amount of re-insurance commission or any repayment or refund (in whole or in part) that forms part of an I-E receipt of the company for the accounting period as a result of section 92"
- deduct acquisition expenses incurred in the accounting period which are refunded or repaid within the accounting period. Any amounts reversed are effectively taxed by being deducted in this way FA2012/S79(9)

Only 1/7 of the adjusted amount of the acquisition expenses referable to an accounting period count as management expenses of the period. For example, step 2 of the FA2012/S76 calculation deducts 6/7 of the adjusted amount. For this first period 6/7 is deducted, regardless of the length of the accounting period.

For each of the next 6 accounting periods (provided each is a year in length) FA2012/S76 treats a further 1/7 as deemed BLAGAB management expenses. If a succeeding accounting period is less than a year, the amount to be treated as deemed management expenses for that accounting period is proportionately reduced.

Any expenses reversed in an accounting period or a preceding accounting period do not count as deemed expenses for that accounting period. In other words, once acquisition expenses are reversed they cease to qualify for relief both in the accounting period in which they are reversed and in any later accounting period

Example of spreading of acquisition costs involving reversed costs

Adjusted acquisition costs incurred in AP20x3 are £70,000. Under step 2 of the FA2012/S76 calculation, only £10,000 is deducted as a management expense in 2013. The remaining 6/7ths are spread and deducted in the next 6 periods under step 3 as deemed management expenses (see LAM04150). In 20x5 £7,000 of these costs are refunded. The adjusted acquisition costs are therefore £63,000 and so the amount allowable in each period (for 2015 and beyond) as a deemed management expense is £9,000. £2,000 of the costs allowed in earlier APs (the cumulative difference between £9,000 and £10,000 for 2013 and 2014) needs to be reversed under Step 4 of FA2010/S76 (see LAM04200)

	20X3	20X4	20X5	20X6	20X7	20X8	20X9
Step 1: Ordinary BLAGAB management expenses of the period that are acquisition expenses	70,000						
Step 2 adjustment: reduce by 6/7 of acquisition expenses	(60,000)						
Step 3 adjustment: bring in brought forward acquisition expenses		10,000	9,000	9,000	9,000	9,000	9,000
Step 4: Reversed expenses claimed in earlier Aps			(2,000)				
Net BLAGAB management expenses	10,000	10,000	7,000	9,000	9,000	9,000	9,000

LAM04120: Calculating 'E': Step 2: Example - spreading of acquisition expenses: FA2012/S79

A life insurance company began trading on 1 July 2013 and has an accounting date of 31 December.

It incurred acquisition expenses of £28,000 in 2013, £42,000 in 2014, and £63,000 in 2015.

Step 3 Deemed BLAGAB management expenses and total acquisitions expenses deducted for the accounting period will be as follows:

Acc'ing Period	Adjusted acquisition costs £	2013	2014	2015	2016	2017	2018	2019	2020
2013	28,000	**4,000**	4,000	4,000	4,000	4,000	4,000	4,000	
2014	42,000		**6,000**	6,000	6,000	6,000	6,000	6,000	6,000
2015	63,000			**9,000**	9,000	9,000	9,000	9,000	9,000
Deemed M.E			4,000	10,000	19,000	19,000	19,000	19,000	15,000
M.E		**4,000**	**6,000**	**9,000**	**-**	**-**	**-**	**-**	
Total Acqu Exp		4,000	10,000	19,000	19,000	19,000	19,000	19,000	15,000

- In 2013 the company includes acquisition expenses of £28,000 in its ordinary BLAGAB management expenses at Step 1. At Step 2 it deducts 6/7ths of £28,000 = £24,000 (even though the AP is only 6 months long, relief is not restricted on a *pro rata* basis, because this is the first AP. Acquisition expenses of £4,000 are relieved

  The balance of the acquisition expenses are relieved as deemed BLAGAB management expenses in future APs
- In 2014 the company includes the acquisition expenses of £42,000 for that AP in its ordinary BLAGAB management expenses at Step 1. At Step 2 it deducts 6/7ths of £42,000 = £36,000. Net relief is therefore £6,000

  The balance of the acquisition expenses is relieved as deemed BLAGAB management expenses in future APs.
- In 2015 the company includes acquisition expenses of £63,000 for the AP in its ordinary BLAGAB management expenses at Step 1. At Step 2 it deducts 6/7ths of £63,000 = £54,000. The company receives net relief of £9,000 for the acquisition expenses of the AP.

13. Deemed BLAGAB management expenses represent the acquisition expenses of earlier APs relieved in the AP. For 2015 these are £4,000 (2013) + £6,000 (2014) = £10,000. The deemed BLAGAB management expenses brought in at Step 3 are thus £10,000.

LAM04200: Calculating 'E': Step 3: Calculate the amount of any deemed management expenses: FA2012/S78(3)

Deemed management expenses for the purposes of calculating E are listed at FA2012/S78(3) and include:

- Spread acquisition expenses (see LAM04100-4120) FA2012/S79
- General annuity business (see LAM04210) FA2012/S83
- Losses from property business where land is held for the purposes of long-term business (FA2012/S87(3)) LAM03080
- A net loss arising from property business referable to the company's BLAGAB business is a deemed BLAGAB management expense FA2012/S87(3).
- Excess debits in respect of intangible fixed assets (FA2012/S88(6)) LAM03060 Where intangible fixed assets debits exceed credits there is an excess debit. For accounting periods beginning on or after 15th September 2016 the excess debit is treated as a deemed management expense for that period. Prior to this the excess debit was carried forward and treated as a deemed BLAGAB management expense of the next accounting period
- Excess miscellaneous losses (FA2012/S89(2)) D. Miscellaneous losses, after set off against miscellaneous income of the accounting period, are carried forward and treated as a deemed BLAGAB management expense of the next accounting period.
- Transitional relief for old general annuity contracts (FA1991/sch7/para16(1)) General annuity business treatment was changed in 1992 and hence consideration of brought forward balances in the few cases where these may still exist is all that is required. Transitional relief is provided by FA1991/sch7/para16(1) as a deemed BLAGAB management expense
- Plant and machinery allowances in respect of management assets (CAA2001/S256(2)(a)) Any plant and machinery allowances in respect of BLAGAB business are treated as deemed BLAGAB management expenses for the accounting period
- Loan relationship deficit carried forward from previous APs (CTA2009/S391(3) LAM03060. Any unused loan relationship deficit is carried forward to the next accounting period and treated as a deemed BLAGAB management expense
- Remediation relief for contaminated or derelict land (CTA2009/S1162) see LAM04030
- Manufactured dividends (CTA2010/S814C(7)). Where a manufactured dividend referable to BLAGAB is paid by the company and it has received the real dividend as a property income distribution from a UK REIT, taxable by virtue of CTA2010/S548(5), then the payment is a deemed BLAGAB management expense (the rules were slightly different pre 1/1/2014)

LAM04210: Calculating 'E': Step 3: General Annuity Business: FA2012/S83

Payments to policyholders or annuitants are not within the definition of 'ordinary BLAGAB management expenses' in S77. In certain circumstances, though, FA2012/S83 provides for a deduction as 'E' for what is effectively the part of the annuity payment that is income as opposed to a repayment of capital.

These rules only apply to a 'qualifying BLAGAB annuity' as defined in FA2012/S83(3) as:

- referable to BLAGAB. Most annuities written by life companies are pension annuities and would not be within the BLAGAB rules
- paid under a contract made in an accounting period beginning on or after 1 January 1992 (pre 1992 contracts are dealt with under FA1991/sch7/para16(1))

The aim is to mirror the treatment for income tax purposes, where the capital element received by the annuitant is not taxed. As the income element is taxed on the annuitant, the company can obtain a deduction as BLAGAB expenses.

The capital element of a BLAGAB annuity is determined in accordance with the purchased life annuity legislation at Income Tax (Trading and Other Income) Act 2005 - ITTOIA2005/S 717ff.

Steep reduction annuities FA2012/S84

The rules for determining the capital elements in ITTOIA2005/S 717ff are modified if the annuity is a 'steep-reduction annuity'. This is an anti-avoidance provision introduced in FA 1997 to target artificial exploitation of the purchased life annuity rules in section 724 ITTOIA 2005.

The essential element of such an annuity is a payment provided for by the annuity contract which, as compared with any previous payment, represents a 'substantial reduction'. 'Substantial reduction' is not defined. A reduction of less than 20% would not normally be regarded as "substantial", but that would have to be judged in the light of all the circumstances, including whether it was one of a series of reducing payments.

Although it would be simpler to compare one single payment with any other, there are ways in which that could be exploited, and ways in which it could give an unfair result. For example, an annuity may provide an annual payment but be varied to provide a monthly payment, where the monthly payments are one-twelfth of the previous annual payments. If the payments are considered in isolation, there would be a steep reduction. If, however, an annuity provides for (say) 5 annual payments of £100,000 followed by a payment of £100,000 after 50 years, there would never be a payment which by itself represented a substantial reduction compared with any previous single payment, but the economic effect of the annuity is much the same as if small payments were made annually from year 6 to year 50. The legislation therefore provides that where there are different intervals between annuity payments the comparison is based on the annualised rate of accrual – FA2012/S84(2)&(3).

In the case of a steep-reduction annuity, the annuity is treated as two, one consisting of the unreduced payments, and the other consisting of the rest – FA2012/S83(6). The consideration for the annuity is apportioned between the two deemed annuities on a just and reasonable basis – FA2012/S83(5)(b). If there is more than one steep reduction, the annuity is carved up into as many separate annuities as are necessary – FA2012/S83(7).

Payments made in respect of pre-1992 contracts – FA2012/S85

Where an insurance company makes a payment in respect of a general annuity under a group annuity contract made in an accounting period which began prior to 1 January 1992 but it was only in an accounting period beginning on or after 1 January 1992 that that annuity first impacted the company's liabilities, the payment is treated as if the contract was made in an accounting period beginning on or after 1 January 1992 and is thus within the scope of FA2012/S83.

Similarly, where a reinsurer makes a payment in respect of a general annuity under a reinsurance treaty made in an accounting period which began prior to 1 January 1992 but it was only in an accounting period beginning on or after 1 January 1992 that that annuity first impacted the reinsurer's liabilities, the payment is treated, as regards the reinsurer, as if it was made in an accounting period beginning on or after 1 January 1992 for the purposes of FA2012/S83(3)(b).

LAM04300: Calculating 'E': Step 4: Calculate the basic amount: FA2012/S76

Step 4 calculates the basic amount of BLAGAB management expenses as follows:

- add ordinary BLAGAB management expenses from step 1, as adjusted at step 2, and
- deemed management expenses from step 3 then
- deduct any "expenses reversed in the accounting period" and
- any BLAGAB trade loss relieved for the accounting period

An example calculation is set out in LAM04500

FA2012/S78(4) defines "expenses reversed in the accounting period" as those which were

"relieved in any previous accounting period in accordance with step 1 (as read with step 2) or step 3 of s76"

but which are "subsequently reversed in the accounting period".

The use of the word "relieved" is significant. It is only expenses which have actually been relieved which are treated as reversed: acquisition expenses which have been spread but have not yet been relieved are not treated as reversed.

S79(9) separately provides that any acquisition expenses reversed in an accounting period or an earlier accounting period must not count as deemed acquisition expenses for the accounting period in question. This ensures that, while the adjustment at Step 4 of s76 claws back any relief which has been given, no further relief is given. See example LAM04110

BLAGAB trade loss relieved for the accounting period means a BLAGAB trade loss:

- relieved against total income of the accounting period (CTA2010/S37) – FA2012/123
- group relieved under CTA2010/Part5/chapter4 FA2012/S125
- brought forward from the previous accounting period and relieved against total profits under FA2012/S124B

Guidance on BLAGAB trade losses is in LAM07130.

LAM04400: Calculating 'E': Step 5: The adjusted BLAGAB management expense

The final step to arrive at 'E' is to add any excess BLAGAB expenses carried forward from the previous accounting period, resulting either from a negative amount at step 6 of the 'I-E' calculation (see LAM02060) or arising from an adjustment required following the application of the minimum profits test (FA2012/S93(5)) (see LAM07170) The example in LAM04500 illustrates this.

LAM04500: Calculating 'E': Example steps 1 to 5 - 'adjusted BLAGAB management expenses': FA2012/S76

This is a simple example to illustrate the way the steps work.
In the year to 31st December 20X5 Lifeco A's income statement showed accounting debits of £90,000 for items that qualify as expenses of management. This included £11,000 of accounting debits related to tax acquisition expenses (both amortisation of pre-20X5 and 20X5

acquisition expenses). In 20X5, tax acquisition expenses of £21,000 were incurred and first amortised in the accounts. The ordinary BLAGAB management expenses in Step 1 are calculated as follows:

	£
Accounting debits for expenses of management	90,000
Strip out debits for all acquisition expenses	(11,000)
Add-back total amount of 20X5 acquisition expenses	21,000
Step 1: Ordinary BLAGAB management expenses	**100,000**
Step 2: 6/7ths of the current period acquisition expenses are deducted	**(18,000)**

Step 3 is to add deemed BLAGAB management expenses. In Lifeco A's case, these are all brought forward acquisition expenses.

Before adjusting for reversals of acquisition expenses, Lifeco A has spread acquisition expenses from earlier periods falling to be relieved in 20X5 of £5,000. However, there were the following reversals of expenses in 20X5:

	£
Acquisition expenses incurred in 20X3	7,000
Non-acquisition expenses incurred in 20X4	4,000

The reversal of the non-acquisition expense does not affect the spreading of brought forward acquisition expenses. However, the reversal of the acquisition expense incurred in 20X3 means that the amount of acquisition expenses to be reversed is reduced by 1/7th of £7,000, i.e. £1,000. This gives a Step 3 total of £4,000 (£5,000 less £1,000).

Step 3: Deemed BLAGAB management expenses **4,000**

Step 4 is to deduct reversals of expenses, insofar as relief has been obtained for them in an earlier period, and to deduct the amount of BLAGAB trade losses utilised otherwise than against BLAGAB trade profits of the period.

The deduction for reversals is as follows:

	£
Acquisition expenses incurred in 20X3 (2/7ths)	2,000
Non-acquisition expenses incurred in 20X4 (full amount)	4,000
	6,000

This is because relief for 1/7th of the 20X3 acquisition expenses has been received in each of 20X3 and 20X4. Relief for all the 20X4 non-acquisition expense was received in 20X4.

The balance of the £7,000 acquisition expenses reversal after the 20x5 adjustment of £4,000 will be deducted from the carry forward balance of spread expenses.

Lifeco A surrendered a BLAGAB trade loss of the period of £20,000 as group relief.

Step 4: Deduction for reversals and utilised BLAGAB trade loss **(26,000)**

Lifeco A carried forward excess BLAGAB expenses from 20X4 of £15,000. These are added at Step 5.

Step 5: Brought forward excess BLAGAB expenses **15,000**

The adjusted BLAGAB management expenses are the total of Steps 1 to 5.

Adjusted BLAGAB management expenses for 20X5 **75,000**

The above can be summarised as follows:

	Calculation of adjusted management expenses	£	£
Step 1	Ordinary BLAGAB management expenses LAM04030-60		100,000
Step 2	Deduct 6/7ths of acquisition expenses LAM04110		(18,000)
			82,000
Step 3	Add Deemed BLAGAB management expenses LAM04210		
	Spread acquisition expenses from earlier periods	5,000	
	Less acquisition expenses reversed in 20X5 (1/7 of £7k) LAM04110	(1,000)	4,000
	Basic amount of adjusted management expenses		86,000
Step 4	Adjust for expenses repaid/ reversed in 20X5 LAM04110		
	Non-acquisition expenses –deducted in full in 20X3	(4,000)	

	Acquisition expenses 2/7 x £7k deducted in 20X3 and 20X4	(2,000)	(6,000)
	Deduct BLAGAB trade loss relieved LAM07310		(20,000)
			60,000
Step 5	Add Management expenses brought forward from 20X4		15,000
	Adjusted BLAGAB management expenses for 20X5		**75,000**

LAM05000: Apportionment rules

LAM05010 Apportionment rules: introduction

LAM05020 Summary of three main apportionment rules: commercial allocation

LAM05030 Acceptable Commercial Method: agreement of a method

LAM05040 Acceptable Commercial Method: income, chargeable gains and expenses: FA2012/S97-101

LAM05050 Allocation of BLAGAB income and gains: direct or factual allocation

LAM05060 Allocation of BLAGAB income and gains: indirect allocation methods

LAM05070 Allocation of BLAGAB income and gains: with-profits funds: FA2012/S98

LAM05080 Example of a commercial allocation for a with-profits fund

LAM05090 Allocation of BLAGAB income and gains outside a with-profits fund

LAM05100 Allocation of BLAGAB gains: Specific consideration for allocation of gains under: FA2012/S101

LAM05110 Allocation of BLAGAB and non-BLAGAB trade profits**:** FA2012/S114-115

LAM05120 Disaggregating profits and losses: FA2012/S98

LAM05010: Apportionment rules: introduction

FA2012/S97 and S114

This chapter explains the rules for apportioning I-E income, gains, losses and expenses and apportioning trade profits, for proprietary insurers, where companies carry on both BLAGAB and non-BLAGAB business.

An insurance company is taxed on its long-term business on a different basis depending on whether the business is BLAGAB or 'other long-term business' - referred to as 'non-BLAGAB':

- BLAGAB is taxed on the I-E profit chargeable under FA2012/S68 (LAM03000)
- non-BLAGAB or other long-term business is taxed on a trading basis under CTA2009/S35 (FA2012/S71) (LAM07000)

Accordingly, it is important to understand the categories of long-term business as defined in FA2012/S56-63. The categories are listed below and the definitions are explained in more detail in LAM01000.

Apportionment rules apply where an insurer writes both BLAGAB and non-BLAGAB	
Non-BLAGAB	BLAGAB
Life Assurance Business Pension 'New' Protection Child Trust Fund Business (CTFB) Individual Savings Account Business(ISAB) Overseas Life Assurance Business (OLAB) Life Reinsurance Business (LRB) Immediate Needs Annuity business	Life Assurance Business Any business other than non-BLAGAB Includes: - protection written pre- 1 January 2013 - certain reinsurance of BLAGAB business
Permanent Health Insurance (PHI)	
Long Term Business	

A detailed explanation of the tax basis for these categories of business is in LAM03000 (BLAGAB I-E) and LAM07000 (Trade Profits).

FA2012/S66(1) requires BLAGAB and non-BLAGAB long-term business to be treated as separate businesses. However, life insurance companies will often hold assets backing both BLAGAB and non-BLAGAB policies in a common pool and will normally incur expenses, such as overheads, that relate to all their categories of business. FA2012/S97-101 sets out the rules for splitting total income, gains, losses and expenses between BLAGAB and non-BLAGAB (LAM05020).

The profit or loss of the long-term business and any tax adjustments required will also need to be allocated between the two businesses. FA2012/S114 sets out how this should be done (LAM05110).

Assets forming part of the company's long-term business fixed capital (LTBFC) (FA2012/S137) are not treated as held for the purposes of the company's long-term business

for tax purposes (FA2012/S122). Any income (FA2012/S74(6)) or gains (FA2012/S75(3)) from such assets do not need to be allocated between BLAGAB and other long-term business. LAM11000

Assets, income and expenses backing any general insurance business will be separately identified and accounted for and therefore no apportionment is necessary.

LAM05020: Summary of three main apportionment rules: commercial allocation

Where apportionment is required between BLAGAB and non-BLAGAB the rules are set out separately for the I-E calculation and for trade profits. The I-E apportionment rules ensure that appropriate income, losses/deficits, expenses and chargeable gains/losses are apportioned to BLAGAB. The trade profits apportionment rules split the accounting profits and tax adjustments between the BLAGAB and non-BLAGAB trading profit computations.

Apportionment rules for I-E charge S97- 101		**Trading apportionment rules S114/115**
INCOME - Credits and other income. **EXPENSES**, debits and other losses and expenses referable to BLAGAB LAM05040 I-E FA2012/S73 steps 1,3,4,&5	**GAINS** - Chargeable gains and allowable losses referable to BLAGAB LAM05040 I-E FA2012/S73 step 2	**Trade Profit -** GAAP profit and tax adjustments are to be allocated between BLAGAB and other long-term business (non-BLAGAB) LAM05110

These apportionment provisions are referred to as 'commercial allocation' in S98 and S101 (for I-E apportionment) and S115 (for profit apportionment). As the name implies, the intention is that the apportionments reflect as far as possible the underlying commercial position.

Although the methods for income, gains and trade profits have their own distinct provisions, there is an overriding requirement that there must be consistency between them (S98(5)(a), S101(5)(a) and S115(4)). Consistency does not require an identical approach to be applied across the various allocation methods, but the overall effect of the methods taken together must be fair.

Income and gains may not contribute to trade profit as there is an offsetting movement in liabilities. However, the income and gains would be included within the I-E calculation.
For example, if:

- income from assets held to support guarantees is allocated to a particular group of policies for the purposes of identifying amounts to be included in the "I-E" computation, then
- identification of the BLAGAB-element of any chargeable gains on the disposal of those assets should also have regard to the subset of policies to which they relate (rather than being calculated on some less granular basis, such as mean policyholder liabilities)

Significantly different allocation bases for income and chargeable gains purposes would suggest that more work is needed to develop an allocation basis that meets the consistency requirements of FA2012/S101(5).

Methods are ‘acceptable commercial methods’ if they fairly reflect the:

- amounts referable to BLAGAB for a period of account (in the case of BLAGAB income, losses and expenses) – S98(3) LAM05040
- (in relation to BLAGAB chargeable gains) the contribution of the assets to the company’s BLAGAB chargeable gains S101(3) – LAM05100
- (in respect of trade profits) the contribution made by each of BLAGAB and other long-term business to the overall accounting profits and tax adjustments (FA2012/S115(2) LAM05110)

Overall, a method that is fair will reflect the underlying commercial position, taking into account the company’s own systems for identifying policyholder returns and measuring the profitability of the products and any other relevant commercial information used by the company.
There are (unused as at June 2018) regulation-making powers within FA2012/S98(4), S101(4) & S115(3) that would allow, in particular cases, for specified allocation methods to be either prohibited or required.

LAM05030: Acceptable Commercial Method: agreement of a method

The onus is on the company to develop and adopt methodologies that meet the statutory requirements and submit its return accordingly. HMRC encourages companies to discuss any new methodology, or changes to existing methodologies with a view to agreeing a suitable method, that complies with statute, before it is used in making a return.

HMRC would expect companies to document (and, on request, share details) how their allocation methodology:

- relates to the company’s internal accounting systems
- how those accounting systems support its commercial objectives. It is expected that there will be variation in the sophistication of allocation within commercial systems

It is for a company to use a method which meets the statutory requirements when it makes its return. However it is to be expected, and encouraged, that companies may seek to discuss proposed methods in advance. Such discussions are helpful to both sides – and can result in a suitable method being effectively agreed before it is used in making a return. Although such a method will still remain subject to possible enquiry it would be unusual for the principle of any previously agreed method to be challenged, unless there has been a material change of facts. In these circumstances the company should be asked to demonstrate that the method continues to fairly represent the underlying reality and does not artificially distort the result of the method

It is not expected that agreed allocation methods applied by a company will change significantly from year to year, unless in response to major changes to the business, or the way in which it operates or is managed.

LAM05040: Acceptable Commercial Method: BLAGAB income, chargeable gains and expenses: FA2012/S97-101

This section summarises the apportionment rules in FA2012 Chapter 4 and references to further explanations.

The basic requirement is that amounts should be determined using an 'acceptable commercial method' which must fairly reflect the individual definitions for each category. In most cases, it is the allocation of income and gains that requires the most attention. This is because life insurers will often hold assets that are not separately identified as backing either BLAGAB or non-BLAGAB - the same pool of assets backs both types of business.

The items allocated under SS97 to 101 are:

- income items listed in s74(1)
- chargeable gains and allowable losses
- debits and other losses listed in s98(6)
- expenses

Capital allowances of management assets are allocated using Chapter 7 rules (s255(2) CAA 2001).

The allocation of income and gains should reflect the way in which the life insurer itself allocates the income and gains from its assets to the underlying policies. At a high level, the income, gains and expenses allocation is illustrated below:

<table>
<tr><th colspan="2">Simplified summary of allocation basis S97-101</th></tr>
<tr><th>Income and Chargeable Gains</th><th>Expenses</th></tr>
<tr><td>1. Income and gains on a factual (direct) allocation basis where:
• assets wholly or partly matched to BLAGAB liabilities (S100 for example, assets matched to unit-linked policies,LAM05050) or
• underlying accounting records allocate income and gains from specific pools of assets to underlying policy liabilities LAM05050

2. Where assets are not allocated or ring-fenced internally to products an indirect method is required that produces a fair result (for example, asset share for with-profit business) LAM05060.

3. Using the mean of policyholder liabilities as an allocation basis could be considered if other methods are unavailable.</td><td>Expenses may be allocated to specific products on a factual basis but other methods may be used, such as allocation based on allocation keys.</td></tr>
</table>

Note that chargeable gains are calculated on the disposal or part disposal of a whole asset and the resulting gain or loss is then apportioned according to the commercial method. Apportioning chargeable gains may be more complex, if for example assets disposed of have been held over a period when the proportions of BLAGAB to non-BLAGAB have changed significantly. LAM05100

The fund structure will also influence the allocation method and needs to be understood. For example a company with only unit-linked funds will have assets directly matched to specific funds so the direct or factual allocation required under FA2012/S100 is straightforward

LAM05050. For a large with-profits fund, the allocation method may require a mix of matching, ring-fencing, asset share or other indirect methods. LAM05070.

Trading profit allocations should be on a consistent basis with the S97 to 101 allocations – see LAM05110.

LAM05050: Allocation of BLAGAB income and gains: direct or factual allocation

Factual allocation is used where income and gains are directly attributed to particular lines of business. Where this is the case the same direct allocation should be followed for tax purposes and for trading profit allocation.

The main categories where this applies will be assets either matched or ring-fenced/allocated by the company to BLAGAB.

Assets wholly or partly matched to BLAGAB: FA2012/S100

FA2012/S100 refers to allocation of chargeable gains and losses where assets are wholly or partly matched to BLAGAB. Where specific assets or pools of assets are matched or partly matched to particular types of BLAGAB policy, the allocation of those assets (and related income, gains etc.) to BLAGAB should follow that attribution.

'Assets matched to liabilities' is defined in FA2012/S138. An asset is matched to a liability if, in accordance with the 'applicable method' (broadly the commercial allocation), some or all of the income or other return arising from that particular asset is specifically referable to that category of business.

To be 'specifically referable' the allocation of the income or other return is a consequence of a contractual requirement imposed on the company relating to the category of business- S138(8).

FA2012/S100 also refers to assets partly matched to BLAGAB liabilities where the 'appropriate proportion' of any gain or loss is allocated to BLAGAB. LAM03210

Although S100 relates to chargeable gains and losses, there is a requirement for consistency between the methods for income and gains at S101(5). This does not mean that there is the same allocation of chargeable gains arising on the disposal of an asset and income and credits arising from the same asset in every case. However, we would expect in most cases that the same approach should be adopted when allocating income and credits arising on assets that fall within S100. This would also be consistent with how income and credits are allocated commercially for unit linked polices.

Assets not matched to BLAGAB: Internal ring-fencing/allocation: FA2012/S101

Where specific assets or pools of assets are linked or otherwise directly attributable to particular types of policy, the allocation of those assets (and related income, gains etc.) between BLAGAB and other long-term business for tax purposes should follow that attribution.

Assets may not be formally linked but the company's internal management and accounting systems may allocate or ring-fence particular assets, and therefore the income and gains arising, to cover liabilities on particular policies or categories of polices. The commercial allocation should fairly represent the contribution the assets have to the business for tax purposes, in most cases it would be expected to follow the internal allocation of assets.

For example, a separate pool of assets may be held to support liabilities related to particular blocks of policies, such as annuity business, or assets held to support the cost of guarantees on specific policies.

The company's regulatory returns are likely to tell you more about the structure of the company and this should be reflected in the company's commercial allocation method.

Example of S100 and S101

For a propriety life company only writing business that is unit linked and annuity business where assets are ring-fenced to that business, the commercial allocation of income might look like this:

Pools of assets £'m	**Liabilities**	**Taxable Income**	**Nature of assets**
Unit-linked BLAGAB	400	7	Mainly equities
Unit-linked Pension (non-BLAGAB)	600	10	Also mainly equities
Non BLAGAB pension annuity business	500	50	Backed by bonds so higher proportion of taxable income
Other long-term business assets (BLAGAB and non-BLAGAB)	200	10	Mean liabilities BLAGAB 25: Non-BLAGAB 75

- dividends are not taxable income under I-E
- the unit-linked BLAGAB taxable income of £7m is all factually allocated loan relationship income and is taxed in the I-E computation LAM03000
- pension annuity business is non-BLAGAB and so there is no income to allocate to BLAGAB. It will therefore only be included in the trading profit computation and will not be included in the I-E
- for the other long-term business the company has determined that mean liabilities is an appropriate commercial allocation method. The £200m liabilities relate to a mix of BLAGAB and non-BLAGAB and are apportioned on a mean liability basis such that £2.5m is allocated to the I-E computation
- total BLAGAB income in the I-E will therefore the £2.5m plus the £7m to £9.5m in total

LAM05060: Allocation of BLAGAB income and gains: indirect allocation methods

Where a company's assets are not matched or internally ring-fenced, an indirect method of allocation of income and gains must be used. Life insurance companies will often hold assets to back a broad range of business categories, for example to meet capital requirements, with income not directly allocated by the company's internal accounting systems. Where this is the case an indirect method of establishing the BLAGAB-element of the income must be adopted. It should be consistent with the method adopted for allocating trading profit between BLAGAB and other long-term business under S115.

Note that:

- for all chargeable gains, S101(3) requires that the method must fairly represent the contribution of the assets to the company's BLAGAB during the period that they have been held for the company's long-term business. This is explained further in LAM05100. Otherwise the requirements for income and gains are aligned

- when allocating a single category of income, loss or expense between BLAGAB and non-BLAGAB under S98, then the allocation of a specific item should not be capable of resulting in one positive and one negative figure. Possible approaches to developing such indirect allocation methods will vary according to the specific circumstances of each company. In particular, there may be different approaches required depending on whether assets are within a with-profits fund or not

LAM05070 sets out considerations for unmatched (non-linked) assets in a with-profits fund with an example in LAM05080. LAM05090 sets out considerations where assets are held outside a with-profits fund.

LAM05070: Allocation of BLAGAB income and gains: with-profits funds: FA2012/S98

A with-profits fund is a pool of assets backing a defined block of long-term business. The shareholder is entitled to a defined revenue flow from the with-profits fund which comprises the shareholder profit each year from the fund less any expenses of administering policies in the fund that are not otherwise charged to the fund. All remaining value in the fund is for the benefit of policies comprising the defined block. The fund may contain other business, for example unit-linked or non-profit business. The with-profit policyholders will share the profit on that business. The unit-linked and non-profit policyholders will only get what they are entitled to under their policies.

Solvency II regulation would include with-profit funds within the definition of 'ring fenced funds'. The assessment of trade profits arising from a with-profits fund is considered separately in section LAM05110.

The commercial allocation of income and gains arising in a with-profits fund for actuarial purposes, rather than tax purposes, derive from the requirements set out in the relevant Principles and Practices of Financial Management (PPFM) which are a regulatory requirement for a with-profits fund. The PPFM will describe the derivation of the asset share for each policy. This represents the amount the with-profits fund that notionally backs the future benefit payment due to the policyholder under each policy. Entitlements may also be governed by other documentation, such as Part VII schemes or other legal reconstruction documentation. Generally, the asset share represents an accumulation since inception of premiums less expenses and payments to policyholders allowing for investment returns earned on the assets backing the asset share (and allowing for policyholder tax where relevant) and perhaps other items. With-profit funds may also have accumulated 'estates'. The estate is the excess of the total with-profit fund over the sum of all asset shares (or guarantees if these exceed asset shares). An example giving rise to an estate is where investment returns have been good and insurers have been prudent in deciding how much of the return to hold back for future smoothing of benefits.

Hence the allocation of income and gains to asset shares provides the basis for the apportionment of income and gains each year.

Apportionment based on asset shares

There is no single correct approach for apportionment. Where income or gains arising from an asset (or category of asset) has/have the effect of increasing the asset share of with-profits policyholders it would be reasonable to base a commercial allocation on the asset share split of the various types of policy to whose asset share the income contributes.

For example, if income arose within a with-profits fund whose asset share split between BLAGAB and other long-term business in the proportion 25:75 it may be reasonable to regard

25% of the income as relating to BLAGAB (since it is anticipated that ultimately 25% will be paid out to BLAGAB policyholders).

Other apportionments

Not all income from assets held by a with-profits fund contribute to policyholders' assets shares. Where this is the case any allocation of income should have regard to the purpose for which the assets is held.

For example, a with-profits fund may hold assets to back non-profits (NP) business where the profits of that NP business belong to the with-profits fund. For the I-E allocation you look at the underlying policies the assets back. So the income from assets would be apportioned between BLAGAB and other long-term business based on the business mix within the NP business being supported – for example by reference to mean policyholder liabilities. But when it comes to profit after all the offsets, the profit has to be allocated according to the with-profit policyholder split.

LAM05080: Example of a commercial allocation for a with-profits fund

This example is a simplified view of a commercial allocation. It is for illustrative purposes only and should not be regarded as specifying any particular method. In a with-profits fund an asset share or direct allocation method would be preferred methods for allocating income and gains but each life company's commercial allocation method will be different and will depend on a number of factors, including the internal accounting records maintained, materiality and the underlying legal and regulatory position.

Description of business	Allocation method	BLAGAB – s98	Trade profits – s114 allocation
Mix of separate asset pots drawn from single pool. Overall bonuses for each policyholder determined by asset share.	Asset share	28%	By reference to bonus allocation
Non-profits business in with-profits fund	Mean of all NP liabilities in with-profits fund	55%	By reference to bonus allocation
Other non-profits business within with-profits fund: all non-BLAGAB	Direct allocation	0%	By reference to bonus allocation
German branch with-profits business: all non-BLAGAB	Direct allocation	0%	By reference to bonus allocation
Non-profit policies	Linked assets = direct allocation. Non-linked assets = mean of liabilities	4% 7%	Linked assets: Allocation directly from accounting records Non-linked assets: by reference to bonus share if direct

			asset allocation not possible.
German branch NP business – all non-BLAGAB	Direct allocation	0%	allocation directly from accounting records
Unit-linked BLAGAB	Direct allocation – all BLAGAB	100%	allocation directly from accounting records

NB. Trade profits: see LAM05110

Not all companies have with-profits funds and some companies will have multiple with-profits funds. Assessing whether a commercial allocation method is appropriate requires a basic understanding of the fund structure as well as the allocation systems and records in the company.

As mentioned in LAM05070 a with-profits fund may have an accumulated estate. An allocation method will also have to be agreed for these assets.

LAM05090: Allocation of BLAGAB income and gains outside a with-profits fund

Assets held outside a with-profits fund may be in a single pool or may comprise a number of separately managed, identifiable pools of assets. For example, assets held to back unit-linked liabilities will be identifiable and separate for BLAGAB and non-BLAGAB. However some individual unit funds are held by both BLAGAB and non-BLAGAB policies and so income and gains arising in these funds will require allocation on a fund by fund basis.

A company may have a separate pool of assets held to provide for future payments under guarantees (for example, a guaranteed minimum return for annuitants). In such cases, it would be reasonable for the BLAGAB-related element of income arising from those assets to be determined by reference to the liabilities for which provision has been made.

Where the assets are held to back a mix of policyholder liabilities, some of which relate to BLAGAB and the rest to other long-term business, allocation should reflect the underlying commercial position. In other words, for what purpose are the assets held? The focus should be on the measure the company uses to drive its business and that the measure used aligns with the allocation of assets within the business.

If no allocation of any kind is made for commercial purposes then it may be reasonable to calculate the BLAGAB-related element by reference to the mean policyholder liabilities (excluding those liabilities where another more specific apportionment has already been made – for example, unit-linked liabilities) of the categories of business that the assets back.

For example, if the assets support a mix of business whose mean policyholder liabilities are split between BLAGAB and other long-term business in the proportion 25:75 it may be reasonable to allocated 25% of the income from those assets to BLAGAB.

If such an approach were adopted for the purposes of establishing the BLAGAB-element of income and gains a consistent approach should be used as part of the method for splitting trading income between BLAGAB and other long-term business (FA2012/S98).

LAM05100: Allocation of BLAGAB gains: Specific consideration for allocation of gains under: FA2012/S101

Chargeable gains not covered (or not wholly covered) by S100 (matched assets, for example,. unit-linked), fall within FA2012/S101. This requires that on disposal of a chargeable asset that is not wholly or partly 'matched' the BLAGAB-element of chargeable gains or allowable losses should be determined in accordance with an acceptable commercial method (LAM05040).

The allocation method adopted must:

- fairly represent the contribution of the assets to the company's BLAGAB during the period that they have been held for the company's long-term business
- be consistent with the methods adopted to establish the BLAGAB element of income, losses and expenses and to divide the trading profit between BLAGAB and other long-term business

For most purposes, these rules are on all fours with the rules for allocating income – it is the same assets producing the income and the gains therefore consistency would be expected. However there is one important difference related to timing.

The main difference from the rules for income is that the allocation must fairly reflect the contribution of the asset to BLAGAB over the whole of the period for which it was held by the company, rather than simply reflecting the use of the asset and pattern of business at the time of disposal.

For example, if an asset is acquired when the proportion of BLAGAB business written was 50% and sold when the proportion was 25%, an allocation of 25% of the chargeable gain to BLAGAB is unlikely to reflect the contribution of the asset to BLAGAB over the period it was held.

However, given the long periods over which assets might be held and the difficulty in accurately calculating the impact of such changes over time, pragmatic approaches are essential.

Where the proportions of BLAGAB and other long-term business have not varied to any significant extent over the period the asset was held by the company it is not necessary to consider any further review. In practice, in most cases, an apportionment of the chargeable gain or allowable loss that mirrors the methodology that was used (or would have been used) to establish the BLAGAB element of income from the asset is likely to satisfy the two requirements (bulleted) above.

Some fact patterns may require a different approach. For example, it may not be appropriate for a gain on long-held commercial property to be allocated on the basis of current year policyholder liabilities if the business mix of the company has shifted markedly over the period of ownership. Policyholders would have been credited with increases in valuation year-by-year not just in the final period.

Holdings in collective investments taxed under TCGA92/S212 are subject to deemed disposals at the end of each period. The holding period is therefore never longer than a year, and so current period apportionment would be appropriate.

Consideration may also need to be given the impact of reorganisations, demutualisation, Part VII transfers or other major transactions.

Although TCGA92/S211 provides for a no gain, no loss transfer, the period over which the transferee has held the asset starts from the transfer date.

In such cases the methodology applied to establish the BLAGAB-element of the gains or losses may require review of the fact pattern in previous periods to produce a better estimate of the contribution of the asset to BLAGAB (LAM 03200).

LAM05110: Allocation of BLAGAB and non-BLAGAB trade profits: FA2012/S114-115

This section explains the requirements for allocation of trade profits to BLAGAB and non-BLAGAB.

An acceptable commercial method for allocating trading profit is likely, in practice, to follow closely the allocation methods for income and gains. As explained below, the allocation of profits arising from with-profit business is likely to be an exception to this general practice. However, the requirement is for consistency rather than exact alignment given that in this case it is general accepted accounting profits 'GAAP' profits that are being allocated as opposed to income and chargeable gains. The general principle is that the commercial allocation methodology for the trade profits results in an allocation that fairly represents the contribution made be each of the businesses

The results of this allocation will feed in to the calculation of:

- the non-BLAGAB trade profits or losses LAM07010
- the BLAGAB trade profits for the purposes of the minimum profits test LAM07230
- BLAGAB losses for purposes of any loss relief LAM15000
- the split of I-E profits between shareholder and policyholder LAM06000

As for allocation of income and gains there are some particular considerations for trade profit allocations depending on the structure of the life company business.

As most of the trading income is usually reserved to fund tax deductible payments to policyholders, the investment return on non-BLAGAB income does not generally produce a substantive net tax liability.

With-profits funds – allocation of trade profits

As stated in LAM05070, a with-profits fund is a pool of assets backing a defined block of long-term business. The shareholder is entitled to a defined revenue flow from the with-profits fund. The shareholder revenue is typically defined in one of 2 ways. For older policy designs (often referred to as conventional business) the shareholder is entitled to a proportion of policy bonuses (often $1/9^{th}$ of the bonuses and also this business is often referred to a 90/10 business). For policies where policy benefits are determined by reference to with-profits units (referred to as unitised with-profits (UWP) business) the shareholder is typically entitled to a percentage of the value of the with-profits units. Both types of business may be written in a single with-profits fund. The rules for determining the profit due to the shareholder and the manner of allocation of all other value between policies are set out in the relevant PPFM. The PPFM will prescribe how policyholders' bonus entitlements are calculated and the amounts that are to be transferred to shareholders from time to time (share of bonus or percentage of the value of UWP units etc.). Both are calculations that will often be determined by 'asset share'.

The contribution of with-profit funds to trade profits is the amount of transfers to shareholders less any expenses of with-profit fund policies that are not otherwise charged to the with-profit

fund. The transfers to shareholders are subject to scrutiny by with-profits actuaries and committees.

The trade profit calculation aims to determine the shareholders share of BLAGAB (and therefore non-BLAGAB) profits. As there is a direct correlation between the percentage of bonuses transferred plus the percentage of UWP fund values transferred and shareholders' profit realisation from a with-profits fund, the split of bonuses and percentage of UWP fund values between BLAGAB and non-BLAGAB policies can provide a reasonable basis for a commercial allocation of with-profits fund trade profits. For example, if the percentage of bonuses and percentage of UWP fund values from a with-profits fund in a particular period were split between BLAGAB policyholders and other policyholders in the proportion 25:75 it would be reasonable for the allocation of the shareholders' profits to be allocated between the two categories of business in the same proportion. Other methods may be appropriate depending on the particular circumstances.

The tax adjustments, are allocated to the two separate businesses in a way that fairly represents the contribution made by those businesses to the accounting profit or loss as adjusted to take into account the tax adjustments.

Assets not in a with-profits fund – allocation of trade profits

The allocation of profits between BLAGAB and other long-term business generated outside a with-profits fund should reflect the contributions of the various categories of business.

In practice, the allocation methods for income, chargeable gains and expenses will already provide information on how income and gains are allocated within the company. The trade profit calculations will in practice reflect the same type of allocations – reflecting what is in the books and records of the company for income, gains and expenses.

Where the company commercially manages particular streams of business and separately calculates profits for those streams the same allocation may be followed for tax purposes.

To the extent that amounts not allocated to a with-profits fund are not directly attributable to particular business streams, for example income from a pool of non-linked assets, an indirect commercial allocation method as used for income and gains, will be needed LAM05060. Any approach adopted for allocating trade profits should be consistent with that used when identifying the BLAGAB element of income and expenses for the "I-E" computation (FA2012/S115).

LAM05120: Disaggregating trade profits and losses

The allocation of a company's overall trading profit (or loss) between BLAGAB and other long-term business may result in a trade profit from BLAGAB and a trade loss from other long-term business (or vice versa). This reflects the reality that two trades could produce very different results, and therefore the allocation method could produce an allowable loss for one business and taxable profit for the other.

This is not the case for commercial allocation of income. FA2012/S98 refers to a method of deciding how much of the credits or other income and the debits or other losses arising from the company's long tern business are referable to BLAGAB. When allocating a single category of income, loss or expense between BLAGAB and non-BLAGAB under S98, then the allocation of a specific item should not be capable of resulting in one positive and one negative figure.

LAM06000: I-E Profit: Calculation of the tax charge

LAM06010	Introduction and Policyholders' rate of tax: FA2012/S68 and S69 and FA2012/S102
LAM06020	Determining the policyholders' share of I-E profit - the policyholders' share: FA2012/S103
LAM06030	Determining the policyholders' share of I-E profit - meaning of "the adjusted amount": FA2012/S104
LAM06040	Determining the policyholders' share of I-E profit - shareholders' share of "BLAGAB non-taxable distributions" (BNTD): FA2012/S105
LAM06050	Determining the policyholders' share of I-E profit - Example

LAM06010: Introduction and Policyholders' rate of tax: FA2012/S68 and S69 and FA2012/S102

FA2012/S68 and S69

FA2012/S68 establishes the charge to corporation tax on an I-E profit.

This section works in conjunction with FA2012/S69 to ensure that it is the I-E profit that is brought within the charge to corporation tax rather than any BLAGAB trade profit calculated under CTA2009/S35. It also supersedes any other provision of the Corporation Taxes Acts that could charge I-E profits to tax and any charge to corporation tax on chargeable gains that are referable to BLAGAB.

Two different rates of tax are potentially charged on the I-E profit. The policyholder rate of tax is charged on the policyholders' share (if any) as a proxy for the tax the policyholder would pay if they held the investment directly, and the main corporation rate of tax is charged on the shareholders' share (if any).

FA2012/S102

FA2012/S102(3) provides that the rate of tax on the policyholders' share of any I-E profit is the rate of tax at which income tax at the basic rate is charged for the tax year beginning 6 April that applies in England, Wales and Northern Ireland, regardless of where the company or its policyholders are resident. That is, the Scottish basic rate does not apply.

LAM06020: Determining the policyholders' share of I-E profit - the policyholders' share: FA2012/S103

A mechanism is required to determine how much of the total I-E profit is attributable to policyholders (and is charged to corporation tax at the basic rate of income tax) and how much is attributable to shareholders (and is charged to corporation tax at the main rate for that year). FA2012/S103 provides that mechanism and delivers a set of rules to determine the policyholders' share of the I-E profit. Any amount of I-E profit that is not attributable to policyholders is treated as shareholder's profit.

In the case of a mutual life insurance company FA2012/S103(2) provides that all of the I-E profit is attributable to policyholders.

For all other cases where there is an I-E profit, a comparison is made between the I-E profit and "the adjusted amount" (see LAM06030) of BLAGAB trade profit for the period to calculate the policyholders' share of the I-E profit (if any).

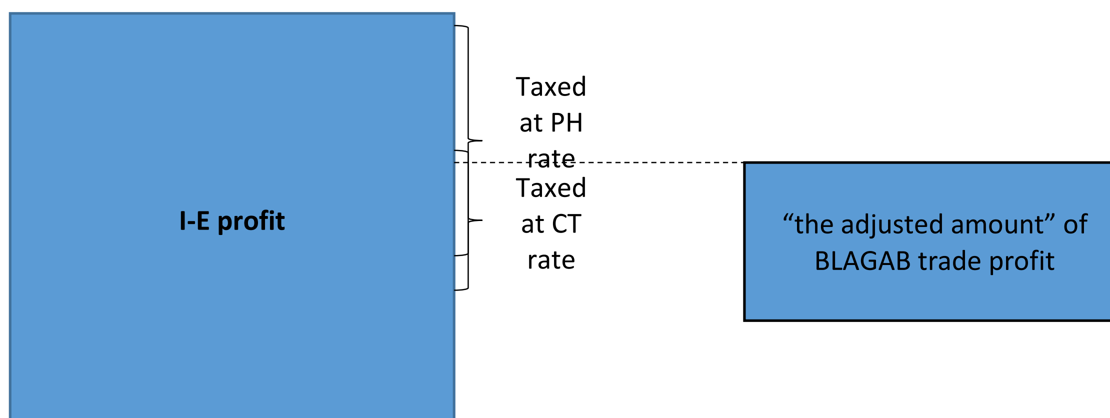
There are three possible outcomes when making this comparison:

1. if the company does not have a BLAGAB trade profit for that period, the policyholders' share of the I-E profit is the whole of that profit;

2. if "the adjusted amount" of a company's BLAGAB trade profit is less than the I-E profit for the period, the difference between those amounts represents the policyholders' share;

3. if “the adjusted amount” of a company’s BLAGAB trade profit is equal to or more than the I-E profit for the period, there is no policyholders’ share.

The second scenario above results in the I-E profit being split between shareholders and policyholders. When this occurs, two rates of tax will be charged. This is illustrated in the diagram below.



In this example the first slice of the I-E profit (up to “the adjusted amount” of BLAGAB trade profit) will be charged at the main shareholder corporation tax rate for the period. The balance will be charged at the policyholder rate of tax (basic rate of income tax).
For a numerical example of the different scenarios possible when calculating the policyholder’s share of the I-E profit, see LAM06050

FA2012/S104 provides the rules for calculating the adjusted amount of BLAGAB trade profits (see LAM06030).

The S103 calculation is also used for the purposes of FA2012/S95 ‘Use of non-BLAGAB allowable losses to reduce I-E profit’. See LAM03410.

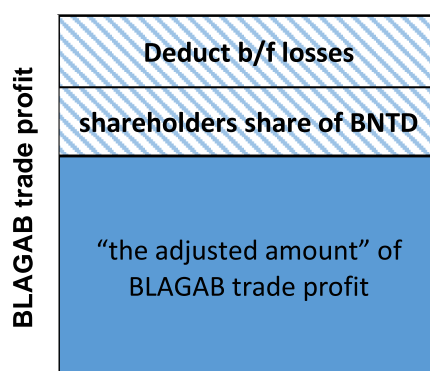
LAM06030: Determining the policyholders’ share of I-E profit - meaning of “the adjusted amount”: FA2012/S104

In FA2012/S103 a comparison is made between the I-E profit and “the adjusted amount” of BLAGAB trade profit for the period (see LAM05030) in order to calculate the policyholders’ share of the I-E profit (if any).

The adjusted amount of BLAGAB trade profit (FA2012/S104) is calculated as:

- the BLAGAB trade profit (see LAM07200) less;
- brought forward BLAGAB trade losses, and then if necessary, further reduced by;
- the shareholders’ share of BLAGAB non-taxable distributions (“BNTD”) as calculated under FA2012/S105 (see LAM06040)

The adjusted amount of BLAGAB trade profit cannot be a negative. Therefore if the BLAGAB trade profit is reduced to nil by the brought forward losses, there is no need to make a further adjustment by deducting the BNTD.



The effect of reducing the BLAGAB trade profit by the brought forward BLAGAB trade losses is to reduce the shareholders' share of the I-E profit in the period.

The new loss restriction rules introduced in F(no.2)A 2017 apply to restrict the amount of BLAGAB trade profits (in excess of £5m) that can be reduced by brought forward BLAGAB trade losses to 50% (Chapter 15 to be updated for Finance Bill (no.2) 2017).

The reason for reducing the BLAGAB trade profit by the shareholders' share of BNTD (see LAM06040) is to allow for a proper comparison to be made between the I-E profit and the BLAGAB trade profit. Distributions are brought into the BLAGAB trade profit calculation but not in the I-E calculation so they must be removed from the BLAGAB trade computation for the purposes of the comparison.

LAM06040: Determining the policyholders' share of I-E profit - shareholders' share of "BLAGAB non-taxable distributions" (BNTD): FA2012/S105

This section provides the rule for determining the amount of BLAGAB non-taxable distributions used to reduce BLAGAB trade profit (see LAM06030) to calculate the adjusted amount of BLAGAB trade profit. This is then used in the comparison required by FA2012/S103 (see LAM06020)

Non-taxable distributions are "BLAGAB" non-taxable distributions if they are allocated to BLAGAB in accordance with the company's commercial allocation method under Chapter 7 of FA2012 (see LAM05010).

The shareholders' share of the BLAGAB non-taxable dividends is the relevant portion of those distributions. The relevant portion is:

$$\frac{BTP}{BNTD + I}$$

BTP is the BLAGAB trade profit as determined for tax purposes before taking account of brought forward losses

BNTD is the amount of BLAGAB non-taxable distributions receivable by the company.
"I" is the total I-E income as calculated under steps 1 to 3 of FA2012/S73 (net loan relationship deficits are deducted at step 4, so not relevant to this calculation).
Note that if the BTP exceeds the BNTD + I, the shareholders' share of the BLAGAB non-taxable distributions is the whole of those distributions. An example of the calculation is provided at LAM06050.

LAM06050: Determining the policyholders' share of I-E profit - example

Consider a set of computations with the following figures.

BLAGAB trade profit (BTP) of the period	800,000
BLAGAB losses brought forward	300,000
BLAGAB non-taxable distributions (BNTD)	150,000
Income (I) calculated under steps 1 to 3 of FA2012/S73	1,450,000

S104 FA 2012 example: Adjusted amount of BLAGAB trade profits

BLAGAB trade profit	800,000
losses b/f	(300,000)*
Shareholders' share of BTND	(75,000)
Adjusted amount of BLAGAB trade profits	425,000

* it is assumed there is no 50% loss restriction in this scenario

S105 FA 2012 example: Shareholders' share of BLAGAB non-taxable distributions

$$\underset{150{,}000}{(BNTD)} \times \frac{(BTP)\ 800{,}000}{((BTND)\ 150{,}000 + (I)\ 1{,}450{,}000)}$$

Shareholders' share of BTND	75,000

S103 FA 2012 example: the policyholders' share of the I-E profit

Where there is an I-E profit, a comparison is made between the I-E profit and "the adjusted amount" of BLAGAB trade profit for the period (see LAM06030) to calculate the policyholders' share of the I-E profit (if any).

- Scenario 1: if the company does not have a BLAGAB trade profit for that period, the policyholders' share of the I-E profit is the whole of that profit;
- Scenario 2: if "the adjusted amount" of a company's BLAGAB trade profit is less than the I-E profit for the period, the difference between those amounts represents the policyholders' share;
- Scenario 3: if "the adjusted amount" of a company's BLAGAB trade profit is equal to or more than the I-E profit for the period, there is no policyholders' share.

	Scenario 1	*Scenario 2*	*Scenario 3*
Assume I-E profits are	625,000	625,000	315,000
Adjusted amount of BLAGAB trade profits	nil	400,000	400,000
Amount of I-E profits charged at shareholder rate	0	400,000	315,000
Amount of I-E profits charged at policyholder rate	625,000	225,000	0

LAM07000: Trade profits

LAM07010	Introduction - BLAGAB and non-BLAGAB trade profits and losses: FA2012/S66
LAM07020	Financial Statements: GAAP for insurance companies: CTA2009/S35
LAM07030	Financial Statements: valuation of technical provisions
LAM07040	Financial statements and tax rules: deferred acquisition costs, deferred income reserves and the value of in force business: FA2012/SCH17/PARA22
LAM07050	Financial statements: fund for future appropriations ('FFA') and unallocated divisible surplus ('UDS')
LAM 07100	Trade profits: taxable investment income and gains
LAM07110	Trade profits: deductible expenditure FA2012/S110 bonuses: capital expenditure: FA2012/S112 index-linked gilts
LAM07120	Trade profits: intangible fixed assets: FA2012/S130 and CTA2009/S806
LAM07130	Trade profits: transitional amounts: FA2012/SCH17
LAM07140	Trade profits: capital contributions
LAM07150	Capital allowances: non-BLAGAB CAA2001/S544(2): BLAGAB CAA2001/S545(2)
LAM07200	BLAGAB trade profits: overview
LAM07210	BLAGAB trade profits: deduction for current and deferred policyholder tax: FA2012/S106
LAM07220	BLAGAB trade profits: expenses or receipts for deferred policyholder tax: FA2012/S107
LAM07230	BLAGAB trade profits: minimum profits test: FA2012/S93
LAM07300	Trading losses: non-BLAGAB
LAM07310	Trading losses: BLAGAB: FA2012/S123-127

LAM07010: Introduction - BLAGAB and non-BLAGAB trade profits and losses: FA2012/S66

Where a life insurance company carries on BLAGAB as well as other long-term business it is treated as carrying on 2 separate businesses for corporation tax purposes by FA2012/S66. These consist of BLAGAB and non-BLAGAB long-term business and separate calculations of trade profits are required for each. Where an insurer also carries on short term business that is treated as a separate trade.

FA2012/S71 provides that in the case of non-BLAGAB the charge to tax arises under CTA2009/S35 with the result that the wider trading provisions in Part 3 of CTA2009 apply. By contrast the charge to tax on BLAGAB business arises under FA2012/S68 and is on the I-E profit. The main purpose of calculating a BLAGAB trade profit is to apply the minimum profits test (LAM07230) and determine the policyholders' share of profits (LAM06010). In addition, if a BLAGAB trade loss arises it may be used in a number of different ways (LAM073100) and a BLAGAB trade loss can arise even where there is an I-E profit.

There are some differences in the method of calculation of BLAGAB and non-BLAGAB trade profits but most of the rules are common to both. The most significant differences, in the case of BLAGAB trade profits, are that an adjustment for policyholder tax is allowed and the Capital Allowances which can be claimed are less restricted than with non-BLAGAB trade profits.

The specific considerations explained further are:

- financial statements: an understanding of some specific features of life company accounts and their interaction with tax; GAAP for insurance companies LAM07020, technical provisions for policyholder liabilities LAM07030, deferred income and expenses LAM07040 and the 'fund for future appropriations' (or 'unallocated divisible surplus') LAM07050
- trade profits: rules for calculating BLAGAB and non-BLAGAB profits; specific rules for inclusion or exclusion of income, expenses and other deductions, including capital allowances LAM07100-07150
- BLAGAB trade profits – purpose of the calculation and specific rules including minimum profits test LAM07200-LAM07230
- trade losses: non-BLAGAB LAM07300 and BLAGAB LAM07310

In the case of mutual business a trade profits computation under CTA2009/S35 is not required.

LAM07020: Financial Statements: GAAP for insurance companies: CTA2009/S35

The starting point for the trade profit calculation is the profit before tax as disclosed by the entity accounts. Of course the accounts do not distinguish between the profits attributable to the BLAGAB and non-BLAGAB businesses and that is determined by FA2012/CHPT7 (see LAM05110).

Trade profits are charged under CTA2009/S35, which means that they must be calculated in accordance with UK generally accepted accounting practice ('UK GAAP') or International Financial Reporting Standards ('IFRS'). Both include accounting standards which specifically deal with insurance contracts: FRS 103 'Insurance Contracts', in the case of UK GAAP, and IFRS 4 'Insurance Contracts' in the case of IFRS.

In general there are no major current differences between IFRS and UK GAAP; however, this may change in future as a new international accounting standard, IFRS 17 Insurance Contracts, is proposed to replace IFRS 4 for 2021 onwards.

Both FRS 103 and IFRS 4 include definitions of insurance contracts and insurance risk; both standards apply to insurance and reinsurance contracts.

IFRS 4:

- defines an insurance contract
- disallows within liabilities provisions for future claims from contracts not entered into at the reporting date, such as catastrophe, equalisation and other statutory provisions
- contains rules on disclosures
- exempts insurers temporarily from some of the requirements of other IFRSs

However the definition of insurance contracts is not necessarily followed for taxation. For example many contracts are classed as investment contracts for IFRS purposes but are still long-term business and taxed as such.

Significantly, IFRS 4 generally permits insurers to continue to use the GAAP approved in their Home State. In the UK this means that FRS 27 'Life Assurance' and the ABI SORP, both now incorporated into FRS 103, will be of relevance even where the company adopts IFRS generally. Under both FRS 103 and IFRS 4 insurers may adopt new accounting policies if they make financial reporting more relevant without adversely affecting reliability, or more reliable without adversely affecting relevance.

LAM07030: Financial statements: valuation of technical provisions

Technical provisions represent the amount that an insurer requires to fulfil its insurance obligations over the lifetime of its insurance contracts. Technical provisions are important for tax because they are generally one of the largest items on the balance sheet and movements directly impact the insurer's profit.

There is no single standard approach to the calculation of technical provisions and different approaches may be used in the financial statements and the regulatory returns. On a Solvency I basis policyholder liabilities may include an implicit prudential margin. Under Solvency II (the regulatory basis since 1 January 2016), technical provisions are calculated from the best estimate of the liabilities plus a risk margin and in some cases a transitional adjustment. It is not normally necessary to challenge the calculation of technical provisions. However if there are potential grounds for challenge accountancy advice will be required.

LAM07040: Financial statements and tax rules: deferred acquisition costs, deferred income reserves and the value of in force business: FA2012/SCH17/PARA22

The costs of acquiring new business, which may be significant, are deferred for accounting purposes. The costs are carried forward as an asset on the balance sheet and released to (that is, charged to) profit or loss over the period in which margins from the related policies are recognised. The Companies Act 2006 defines acquisition costs as "the costs of acquiring insurance policies which are incurred during a financial year but relate to a subsequent financial year". The deferral of acquisition costs acts to offset 'new business strain', that is, the requirement to establish policyholder liabilities at inception of a policy in excess of premiums received for those policies.

Similarly, certain up-front fees received are often deferred and held on the balance sheet as deferred income, often known as a ‘deferred income reserve’. The annual movement on both Deferred Acquisition Costs (‘DAC’) and Deferred Income Reserves (‘DIR’) are recognized for both accounting and taxation purposes but there is a significant exception.

Prior to the introduction of the new life tax regime on 1 January 2013 both income and acquisition costs were fully recognised in the regulatory returns and therefore in the trade profit calculations (other than PHI) without deferral. This meant a transitional difference arose between the regulatory returns and accounts on the move from the regulatory return based tax regime to the FA2012 accounts based tax regime. However DAC and DIR balances were excluded from the transitional calculation LAM14050. The result is that for tax purposes any movements on DAC or DIR balances which were in existence at 31 December 2012 will need to be excluded from the accounting profit in order to avoid double taxation or double relief being given, unless they are referable to PHI.

Under FA2012/SCH17/PARA22 any amounts which have been taken into account in calculating trade profits for an accounting period ending before 31 December 2012 are disregarded in the Section 35 calculation. Insurers should have arrangements in place to track the pre-2013 DAC and DIR balances as they unwind in the post transitional accounts to enable tax adjustments to be made.

Another example where an adjustment under Para 22 will be required is where the insurer acquired an asset described as the value of in force business (‘VIF’) before 1 January 2013. VIF is an asset which relates to the future profits expected to arise from a portfolio of insurance contracts and arises when an insurer acquires a block of business from a third party. The carrying value of the VIF is tested for impairment and amortised through the income statement. Although VIF was an asset which was not recognised for solvency purposes the cost of acquiring the VIF had the effect of reducing surplus, and therefore trade profits, in the regulatory returns before 1 January 2013. As an amount was taken into account in calculating profits any amortisation in the accounts is not deductible for tax if it relates to VIF acquired before 2013. Where the transfer of business took place under the FA2012 provisions VIF assets are specifically excluded from Part 8 by CTA2009/S806(3)(a) and there are specific rules in FA2012/S130 which govern whether VIF is relievable. LAM13000

The Para 22 disregard applies widely to any amounts which were previously tax effective in the regulatory returns, and not brought into account on transition, and is not restricted to DAC, DIR and VIF.

LAM07050: Financial statements: the fund for future appropriations (‘FFA’) and unallocated divisible surplus (‘UDS’)

The FFA is the excess of assets over policyholder liabilities in a with-profit fund after bonuses for the year are declared and allocated to policyholders and after the shareholders’ share is determined. IFRS calls this balance the UDS and allows some flexibility over its presentation though typically in the UK it is included in its entirety within liabilities.

The FFA is defined in the Companies Act 2006 as ‘all funds the allocation of which either to policyholders or to shareholders has not been determined by the end of the financial year’. This balance represents the cumulative amount available for allocation to policyholders in the future. Technically the balance represents in part obligations to policyholders and in part shareholders’ funds, though in the UK it is presented as a liability immediately after shareholders’ funds.

Transfers to and from the FFA or UDS must be accounted for through the technical account (or income statement) and are fully taxable or tax deductible.

LAM07100: Trade profits: taxable investment income and gains

Where trading assets are held for the purposes of the long-term business, and give rise to investment income, that income is taken into account in arriving at profits under Section 35. FA2012 specifically includes:

- dividends and other distributions regardless of whether they would otherwise be exempt FA2012/S111. This does not apply to distributions of a capital nature, which are excluded
- index-linked gilt-edged securities, unless they back PHI linked liabilities, as the rules in CTA2009/S400 onwards are dis-applied by FA2012/S112

Included under normal s35 principles are

- property income which is an exception to the usual property rules and is permitted by CTA2009/201(1A)
- loan relationship debits and credits CTA 2009/PART5
- profits and losses from derivative contracts CTA2009/PART7
- debits and credits in respect of intangibles CTA2009/PART8

Insurance companies reporting under both UK GAAP and IFRS will generally value investments at market value. Any valuation movements on shares and securities which are reflected in the income statement and are not long-term business fixed capital should be included in trade profits.

LAM07110: Trade profits: deductible expenditure FA2012/S110 bonuses: capital expenditure: FA2012/S112 index-linked gilts

The rules for trading expense deductions generally follow ordinary principles though there are some provisions which are specific to life insurance.
Under FA2012/S110 amounts allocated to policyholders as bonuses are deductible unless they are:

- of a capital nature
- allocated to with-profit policyholders
- not funded out of amounts brought into account as receipts in the computation of trade profits

Payments made in connection with the reattribution of inherited estate, where there is an attribution of assets to shareholders, are regarded as amounts of a capital nature.

Some costs incurred in connection with the transfer of an insurance business under Part VII of the Financial Services and Markets Act 2000 may be capital in nature. Further guidance on this point can be found at BIM35525.

In general no deduction for policyholder tax is permitted from trade profits. Policyholder tax is only deductible, or indeed chargeable, in the BLAGAB trade profit computation under FA2012/S106. LAM07200

A deduction for indexation on index-linked gilts under CTA2009/S400 to S400C is specifically disallowed in the trading profit computation for long-term business other than index-linked PHI, by FA2012/S112.

LAM07120: Trade profits: intangible fixed assets: FA2012/S130 and CTA2009/S806

Since 31 December 2012 CTA2009/PART8 has applied to credits and debits on intangible fixed assets arising to life insurance companies. These rules are modified, by CTA2009/S806, to specifically exclude assets derived from or referable to insurance or capital redemption policies.

Assets in respect of the value of in force business are also excluded from Part 8. The amortisation of assets representing the value of future profits arising from business acquired from a third party after 1 January 2013 is separately deductible under FA2012/S130 whereas amortisation relating to such assets acquired before that date is not.

LAM07130: Trade profits: transitional amounts: FA2012/SCH17

Deemed receipts or expenses of the BLAGAB or non-BLAGAB business can arise under the transitional provisions at Part 2 FA2012/SCH17 and are treated as arising over 10 years. They are taken into account in arriving at the BLAGAB and non-BLAGAB trade profit in the year they are deemed to arise.LAM14000

LAM07140: Trade profits: capital contributions

A capital contribution can be made to introduce new capital into a company without the payer taking shares in return or creating a debt. If a payment is made to a company carrying out long-term insurance business in order that the money may be used in the recipient's business, to supplement trading or other business receipts and to enable the recipient to carry on business, or otherwise to preserve and maintain trading stability and solvency, then depending on the specific facts surrounding the payment, it may be a taxable trading receipt. Further guidance can be found at BIM41810.

LAM07150: Capital allowances: BLAGAB CAA01/S545(2); non-BLAGAB CAA01/S544(2)

BLAGAB capital allowances

In computing BLAGAB trade profits or losses capital allowances may be claimed on both management and investment assets. Management assets are defined in CAA01/S544(2) as assets which are used in the management of the long-term business. Only Plant and Machinery allowances, available under Part 2 of the CAA 2001, can be claimed on management assets.

Investment assets are defined in CAA01/S545(2) as assets held by a company carrying on any long-term business for purposes other than the management of that business. In contrast to the computation of non-BLAGAB trade profits (LAM07080) there is no specific rule denying capital allowances on investment assets in computing BLAGAB trade profits. However the company will need to show that it has incurred capital expenditure as required by CAA01/S4 (and any other qualifying conditions are met). But expenditure on plant and machinery in buildings held by it as assets backing its insurance business cannot be relieved under the

capital allowances code, as they are circulating assets and do not fall to be treated as capital expenditure (CAA01/S4 (2)(a)).

Where a company is entitled to an allowance in BLAGAB it is treated as a deemed management expense and is given effect to in I-E under CAA01/S256(2). Although BLAGAB allowances can increase a trade loss, that applies only to the minimum profits test or in determining policyholder profits in a future period (CAA01/S257(2)). This means in effect that BLAGAB capital allowances cannot increase the measure of trade losses available for set off against total profits of the company, of the current or previous period or by way of group relief or carried forward losses.

Non-BLAGAB capital allowances

Management asset plant and machinery allowances can be deducted from non-BLAGAB trade profits. Management assets are defined in CAA01/S544(2) as assets which are used in the management of the long-term business.

CAA01/S545(3) specifically provides that allowances on investment assets are not given in computing non-BLAGAB trade profits. Investment assets in this context are assets which are held for a purpose which is other than the management of the long-term business. In many cases investment assets, such as property fixtures, will be circulating assets of the insurance trade and will not qualify for capital allowances in any event.

CAA01/S255 provides that management capital allowances should be apportioned between BLAGAB and non-BLAGAB in accordance with the rules in Chapter 7 of Part 2 of FA 2017. There is no comparable provision for investment assets. Nevertheless, where the asset backs both BLAGAB and non-BLAGAB business, the allowances will need to be apportioned between the categories following the best available commercial method with only the BLAGAB part being taken account of in computing profits.

CAA01/S187A - S187B make the availability of capital allowances to a purchaser of second-hand fixtures conditional on the pooling of relevant expenditure prior to a transfer, and on the seller and purchaser formally agreeing a value for fixtures within two years of a transfer (or commencing proceedings to reach an agreement). Detailed guidance may be found at CA26470 onwards.

Where the property is held to back only non-BLAGAB business the conditions in CAA01/S187A cannot be met because qualifying expenditure has not been incurred by the seller. Where the property is held for mixed purposes the fixtures may qualify by virtue of being used in a BLAGAB property business CAA01/S11(4) taxed under I-E. Where this is the case, all of the expenditure may qualify notwithstanding that allowances on the non-BLAGAB share cannot be taken account of in computing profits. This means that the provisions in CAA01/S187A can potentially apply if the other conditions are met.

LAM07200: BLAGAB trade profits: overview

BLAGAB trade profits are not charged to tax in the usual way but are used to calculate the shareholder share of tax under I-E and to undertake the minimum profits test. The starting point for the BLAGAB trade profit calculation is the trade profit before tax as disclosed by the statutory accounts. As with non-BLAGAB business the BLAGAB share is determined by FA2012/Chapter 7 LAM05110.

In general terms the BLAGAB trade profits are calculated in the same way as non-BLAGAB trade profits but there are some important differences as follows:

- the capital allowances rules differ LAM07250
- an adjustment for policyholder tax is made

The normal charge to tax on trade profits in CTA2009/S35 does not apply to BLAGAB trade profits. BLAGAB is instead charged to tax under I-E. FA2012/S68 applies the charge to tax to I-E, while S69 specifically excludes BLAGAB from charge under S35.

LAM07210: BLAGAB trade profits: deduction for current and deferred policyholder tax: FA2012/S106

An adjustment is made in the BLAGAB trade profit computation for current and deferred policyholder tax. In essence this provides a deduction for tax borne by a life company on behalf of its policyholders. There are two elements to the adjustment:

- current tax – a tax deduction is allowed under FA2012/S106 for an amount equal to the amount of corporation tax charged at the policyholders' rate of tax on the policyholders' share of the I-E profit for the period. The figure for current tax is taken from the tax computation
- deferred tax – a tax adjustment is also permitted under FA2012/S107 for the movement in the deferred policyholder tax balance for the period

Deferred tax represents the future tax consequences of transactions and events that have occurred by the balance sheet date and is reflected in the accounts in the form of deferred tax balances (assets or liabilities or both). Deferred tax therefore reflects differences between taxable profit and accounting profit (that is, timing differences) or other differences between balance sheet carrying amounts and corresponding tax values (other temporary differences).

The deferred policyholder tax adjustment for trade profit computation purposes is calculated as:

- the closing deferred policyholder tax balance for the period, less
- the closing deferred policyholder tax balance for the previous period

If the amount is a negative figure it is brought into account as an expense in the BLAGAB trade computation.

If it is a positive figure it is brought into account as a receipt in the BLAGAB trade computation. Credit balances, that is, deferred tax liabilities, are taken to be negative figures for the purposes of this calculation, while deferred tax assets are treated as positive figures.

The amount must be calculated in accordance with GAAP and be reflected in the accounts for the period as income or expense in a performance statement. Performance statements include the profit and loss account and the statement of total recognised gains and losses under UK GAAP, and the income statement or statement of comprehensive income under IFRS.

The amount must also be wholly attributable to policyholder tax. See LAM07220 for details of what expenses, gains and losses are regarded as being attributable to policyholders.

Note that the closing balances used for this calculation are not the deferred tax balances shown in the company's accounts. The accounting balances will include both shareholder and policyholder deferred tax items so the company must carry out a supplementary calculation to

establish the elements attributable wholly to policyholder tax. This supplementary calculation is normally shown in the tax computation.

LAM07220: BLAGAB trade profits: expenses or receipts for deferred policyholder tax: FA2012/S107

As indicated in LAM07210, the adjustment to BLAGAB trade profits allowed for deferred policyholder tax must be wholly attributable to policyholder tax.

An amount is wholly attributable to policyholder tax if:

- it is a BLAGAB matter, and
- it is calculated wholly by reference to the policyholder rate of tax

A BLAGAB matter is defined in FA2012/S108(3) as:

- excess BLAGAB management expenses
- deferred acquisition expenses deferred in accordance with FA2012/S79
- any other expense which will be relieved in the future under the I-E rules
- BLAGAB allowable losses under TCGA1992/S210A
- spread deemed disposal gains or losses on TCGA1992/S212 assets
- unrealised gains and losses on capital gains assets

'Excess BLAGAB management expenses' will include the reversal of any minimum profits charge calculated in accordance with FA2012/S93 and treated as carried forward management expenses under FA2012/S94 (see LAM07230).

Note that if an amount is included in the calculation of policyholders' deferred tax for a period and that amount ceases to be wholly attributable to policyholder tax in a future period, a reversal of the tax deduction taken in the earlier period should be made.

LAM07230: BLAGAB trade profits: minimum profits test: FA2012/S93

The objective of the minimum profits test is to ensure that the taxable income of an insurance company is at least equal to the BLAGAB trade profit (excluding dividends) for the period even where the I-E profit would otherwise be a lower amount. The test identifies whether there are adjusted BLAGAB profits in excess of the amount of adjusted I-E profit (or excess BLAGAB expense) and where that is the case step 3 of FA2012/S73 brings an I-E receipt into charge representing that excess and a corresponding amount is carried forward as an expense to the company's next accounting period.

The rationale behind the test is that all profit attributable to shareholders must be taxed. If profits under the I-E basis are lower than BLAGAB trade profits, then the minimum profits test will adjust the I-E profit to at least the level of trade profits.
The test works by comparing the I-E profit (or excess BLAGAB expense) with the BLAGAB trade profit.

Where there are excess BLAGAB expenses ('excess E') these are treated for the purposes of the FA2012/S93 minimum profits test calculation as a negative amount.

Before making this comparison an adjustment is required in respect of any exempt dividends. This is necessary because portfolio shareholdings are trading stock of the insurance business

and therefore those dividends are included in calculation of the BLAGAB trade profit. In contrast I-E profits are calculated on an investment business basis and so the income only includes taxable dividends.

FA2012/S94 requires an adjustment where the BLAGAB trade profit includes non-taxable distributions receivable that are referable to BLAGAB business.

It requires, for this purpose only, the total amount of non-taxable distributions to be included as part of the total ‘I’ calculated in Step 4 of S73.

If adjusted BLAGAB trade profits (after losses b/f) exceed the adjusted I-E profit or excess BLAGAB expenses then an amount equal to the difference is an I-E receipt of the company and the same amount is carried forward to the company’s next accounting period as an expense (see LAM03070)

Example:

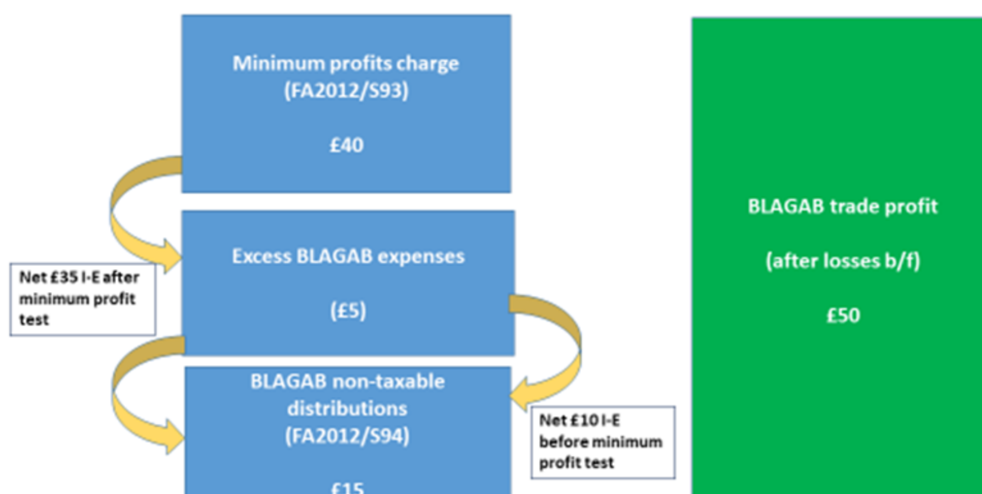
Minimum profits charge
(FA2012/S93)
£10

BLAGAB non-taxable distributions
(FA2012/S94)
£15

I – E profits
£25

BLAGAB trade profit
(after losses b/f)
£50

In this example £10 will be treated as an I-E receipt and £10 will be carried forward as a BLAGAB management expense. The total I-E profits, including the minimum profit charge, will be £35.



In this example £40 will be treated as an I-E receipt and £40 carried forward as a BLAGAB management expense. The total I-E profits, including the minimum profit charge, will be £35.

LAM07300: Trading losses: non-BLAGAB

The normal CTA2010 loss rules apply to non-BLAGAB trading losses which are calculated in the same way as trade profits. This differs from BLAGAB trade losses, which are subject to the restrictions described at LAM07310 and underlines the need for a separate calculation of BLAGAB and non-BLAGAB losses.

LAM07310: Trading losses: BLAGAB: FA2012/S123-127

Relief for BLAGAB trade losses is given by FA2012/S123 to FA2012/S125. Although BLAGAB profits are not themselves charged to tax, BLAGAB trade losses enjoy similar relief to other trade losses, and the loss relief rules mirror closely the loss relief rules for companies generally, allowing relief either:

- sideways against total profits of the period
- carry back against total profits of the previous period
- by way of group relief
- by carry forward to later accounting periods against future BLAGAB profits

BLAGAB trade losses that are relieved by set off against total profits or that are surrendered by way of group relief are subject to some specific qualifications.

Set off of BLAGAB trade losses against total profits

FA2012/S123 broadly permits BLAGAB trade losses to be set against total profits for the accounting period in which they arose and for any excess to be carried back to any accounting periods that end in the preceding 12 months under CTA2010/S37. So BLAGAB losses can be set against the sum of non-BLAGAB trade profits, the trade profits of any General Insurance business and any taxable income and gains arising from long-term business fixed capital assets or non-insurance business assets. However by virtue of FA2012/S127 those losses

cannot be set against the policyholder share of I-E profits despite the fact that they are included in total company profits.

Surrender of BLAGAB trade losses as group relief

Similarly, FA2012/S125 allows BLAGAB trade losses to be surrendered to other group companies under the group relief provisions in CTA2010/S99 onwards.

The BLAGAB trade loss available to a life company to set off or surrender is subject to the restriction in FA2012/S126, which excludes from the loss the amount of the non-trading loan relationship deficits on debtor relationships. The deficit reflects debits and credits arising from debtor loan relationships and derivative contracts only. In other words, debits and credits on creditor loan relationships are ignored for this purpose.

Specific qualifications where BLAGAB trade loss is set off against total profits or surrendered as group relief

Where BLAGAB losses are set against total income or surrendered by way of group relief the amount relieved is deducted from BLAGAB management expenses at step 4 of FA2012/S76. This broadly ensures that a double deduction for the shareholder deficit which is implicit within the I-E charge is avoided.

Carry forward of BLAGAB trade losses FA2012/S124

To the extent that BLAGAB losses are not used in the current year they may be carried forward and used against future BLAGAB trade profits under FA2012/S124. This means that they will be taken into account when applying the minimum profits test (FA2012/S93) and arriving at the policyholders' rate of tax in future years (FA2012/S103).

LAM08000: Full example computation

Computation Index

Schedule	Computation	Links to supporting narrative
A1	BLAGAB I-E computation	LAM03010 – income & gains LAM04010 - expenses
A2	Minimum profits charge	LAM03510
A3	BLAGAB management expenses	LAM04010
A4	BLAGAB trade computation	LAM07010
A5	Non-BLAGAB trade computation	LAM07010
A6	Long-term business fixed capital	LAM11010
A7	Policyholders' share of I-E	LAM06010
A8	Overall tax calculation	LAM08020
A9	Tax liability	
B1	Double tax relief - summary	LAM09010
B2	DTR foreign income – BLAGAB	LAM09010
B3	DTR foreign income – non-BLAGAB	LAM09010
G	Capital gains and losses	LAM03200

A1 - BLAGAB I minus E computation (LAM chapter 3)

				Total
Step 1 – BLAGAB income	Property business		47,701	
	Loan relationship and derivative income		527,136	
				574,837
Step 2 – BLAGAB chargeable gains less BLAGAB chargeable losses	Net chargeable gains		(G)	236,455
Step 3 – Sundry receipts and minimum profits charge	Sundry receipts		455	
	Minimum profits charge	(A2)	9,500	
				9,955
Step 4 – Sum of steps 1 – 3, deduct any BLAGAB non-trading deficit. Result is 'I'	Sum of steps 1 – 3		821,247	
	Non-trading deficit		(2,501)[1]	
	'I'			818,746
Step 5 – Adjusted BLAGAB management expenses 'E'	Less BLAGAB management expenses		(A3)	(288,650)
Step 6 – subtract 'E' from 'I'	I minus E profit / (excess BLAGAB expenses)		(A8)	**530,096**

[1] Computations will often net the non-trading deficit off at step 1.

A2 - Minimum profits charge (LAM03510)

				Total
Adjusted I- E profit / excess BLAGAB expenses	I minus E profit Ignore minimum profits charge Add BLAGAB non-taxable distributions	(A1)	530,096 (9,500) 118,577	639,173
Adjusted BLAGAB trade profit	BLAGAB trade profit Less BLAGAB trade loss b/f	(A4)	650,273 (1,600)	648,673
Compare the adjusted BLAGAB trade profit with adjusted I- E profit	Minimum profits charge		(A1)	**9,500**[2]

A3 - BLAGAB management expenses (LAM Chapter 4)

			Total
Step 1 – Company's ordinary BLAGAB management expenses of the AP	Ordinary BLAGAB management expenses		109,620
Step 2	less six-sevenths of the acquisition expenses of the period		(42,500) 67,120
Step 3 – deemed BLAGAB management expenses – FA2012/S78(3)	Spreading of acquisition expenses Capital allowances on management assets Transitional relief for old annuity contracts	169,150 22,500 8,350	200,000
Step 4 – total of steps 1-3, adjust for expenses reversed in the AP and BLAGAB trade loss utilised	Sum of steps 1 to 3 Deduct relief previously given for expenses repaid in the AP Adjust for BLAGAB trade loss relieved	267,120 (3,600) 0	263,520
Step 5 – add management expenses brought forward to the sum of step 4	Management expenses brought forward Minimum profits charge of previous AP	12,500 12,630	25,130
	Adjusted BLAGAB management expenses	(A1)	**288,650**

[2] The Minimum Profits Charge is carried forward to the next accounting period as an excess management expense

A4 - BLAGAB trade (LAM Chapter 7)

			Total
Accounting profit before tax	Profit before tax		677,211
Adjustments to accounting profit	Disallowed expenses	9,430	
	Capital allowances – management assets	(22,500)	
	Capital allowances – investment assets	(4,850)	
	Pre 2013 Deferred Acquisition Costs (DAC)	11,620	
	Pre 2013 Deferred income	(1,350)	
	Transitional receipt/(expense)	(19,288)	
	Policyholder tax adjustment (A7)	nil	
			(26,938)
BLAGAB trade profit for tax	BLAGAB trade profit		650,273
Less BLAGAB trade loss brought forward	BLAGAB trade loss brought forward	(1,600)	
		(A2) (A7)	**648,673**

A5 - Non-BLAGAB trade (LAM Chapter 7)

			Total
Accounting profit/loss before tax	Loss before tax		(11,255)
Adjustments to accounting profit	Disallowed expenses	3,650	
	Capital allowances – management assets	(2,460)	
	Pre 2013 Deferred Acquisition Costs (DAC)		
	Pre 2013 Deferred income	10,340	
	Transitional receipt/(expense)		
		(7,630)	
		4,350	8,250
	Non-BLAGAB trade loss before foreign tax		(3,005)
	Foreign tax deducted		(2,600)
Non-BLAGAB loss for tax	Non-BLAGAB trade loss		**(5,605)**
	Less offset against other profits	(A8)	(5,605)
Non-BLAGAB trade losses	Current period loss carried forward		Nil
	Non-BLAGAB trade loss brought forward		(5,840)

A6 - Long-term business fixed capital and other non-trade (LAM Chapter 11)

		Total
LTBFC contains structural assets and those grandfathered from pre 1 January 2013 shareholders' funds. Tax rules applicable to investment companies apply.	Loan relationships and derivative income	21,540
	Non-trading gain on intangible assets	7,660
	Chargeable gains	655
	Capital losses not arising from BLAGAB	(655)
	Management expenses	(5,880)
	Non-trading loan relationship deficit brought forward CTA2009/S457(1)	(1,250)
	Profit / (loss) (A8)	**22,070**

A7 - Policyholders' share of I minus E profit (LAM Chapter 6)

		Total
Policyholders' share calculation	I minus E profit (A1)	530,096
	Reduced by adjusted BLAGAB trade profit(below)	(530,096)
	Policyholders' share (A8)	**nil**
Adjusted amount of BLAGAB trade profit	BLAGAB trade profit reduced by brought forward losses (A4)	648,673
	Reduced by shareholders share of BLAGAB non-taxable distributions	(118,577)
	Adjusted BLAGAB trade profit	530,096
Shareholders' share of BLAGAB non-taxable distributions	BLAGAB non-taxable distributions (A2)	118,577
	Shareholders' share of BLAGAB non-taxable distributions (LAM05050)	118,577

A8 - Tax calculation

		BLAGAB I minus E		Long-term business fixed capital	Total per return
Non-trade loan relationship income	(A1)	527,136	(A6)	21,540	548.676
Property business	(A1)	47,701			47,701
Sundry and minimum profits	(A1)	9,955			9,955
Profits before gains	(A1)	584,792	(A6)	21,540	606,332
Net chargeable gains	(G)	236,455		0	236,455
Non-trading gain on intangible fixed assets			(A6)	7,660	7,660
Non trading deficit on loan relationship	(A1)	(2,501)			(2,501)
Management expenses	(A3)	(288,650)	(A6)	(5,880)	(294,530)
Non-trading loan relationship deficits brought forward CTA2009/S457(1)			(A6)	(1,250)	(1,250)
Net profits before reliefs	(A1)	530,096	(A6)	22,070	552,166
Shareholders' profits before reliefs		530,096		22,070	552,166
Less trading losses CTA2010/S37 (non-BLAGAB)	(A5)	(5,605)			(5,605)[3]
Group relief		(120,650			(120,650)

[3] This example does not reflect the operation of the loss streaming rules introduced in FAno2 2017

Shareholders' share of profits		403,841	22,070	(A9)	425,911
Policyholders' share of profits	(A 7)	nil		(A9)	nil
Total taxable profits		**403,841**	**22,070**		**425,911**

A9 - Tax liability

Corporation tax		**Tax**		**Profit**	**Rate**
On policyholders' share of profits					
2016					20.00%
2017					20.00%
Tax on policyholders' profit		nil	(A8)	nil	
On shareholders' profits					
2016		21,016.20		105,081	20.00%
2017		60,957.70		320,830	19.00%
Tax on shareholders' profits		82,063.90	(A8)	425,911	
Tax before DTR		82,063.90			
DTR relief	(B)	(1,112)			
Income Tax set off		(3,556.10)			
Corporation tax liability		**77,395.8**			

B1 – Double tax relief – summary (LAM Chapter 9)

Category	Relevant income	Foreign tax	Creditable tax before limitations	Excess foreign tax	Actual creditable tax	Tax deductible
BLAGAB (B2)	81,420	1,112	1,112	0	(A9) 1,112	0
Non-BLAGAB (B3)	302,897	7,602	6,700	902	(A9) 0	2,600
Total	384,317	8,714	7,812	0	1,112	(A5) 2,600

B2 – Foreign Income – BLAGAB

Source	Relevant income	Foreign tax	Rate %	Foreign tax to 20.25%	Excess foreign tax	Appropriate fraction of relevant expenses (TRE x RI/TI)	Income above expenses TIOPA 2010 s100	Relevant fraction of profits	Income restricted to profits TIOPA 2010 s101	Maximum creditable tax	Actual creditable tax
Overseas shares	19,230	260	1.38	260	0	17,250	1,980	15,631	1,980	400	260
Overseas debentures	62,190	852	1.37	852	0	55,772	6,418	50,551	6,418	1,296	852
Total	81,420										1,112

B3 - Foreign Income – non BLAGAB

A	B	C	D	E	F	G	H	I	J	K	L
Source	**Relevant income**	**Foreign tax**	**Rate**	**Foreign tax to 20.25%**	**Excess foreign tax**	**Appropriate fraction of relevant expenses (TRE x RI/TI)**	**Income above expenses TIOPA 2010 s100**	**Relevant fraction of profits**	**Income restricted to profits TIOPA 2010 s101**	**Maximum creditable tax**	**Actual creditable tax**
Overseas shares	100	15	15%	15	0	67.37	32.63	(276)	0	0	0
Overseas preference shares	18,997	4,749	25%	3,847	902	12,798	6,199	(524)	0	0	0
Overseas debentures	283,800	2,838	1%	2,838	0	191,196	92,604	(7,740)	0	0	0
Total	302,897										0

G – Capital gains and losses (LAM03200)

		Total
Capital gains		
BLAGAB chargeable gains		89,556
TCGA/S212		221,621 *(LAM03300)*
Total before losses offset		311,117
BLAGAB losses	(below)	(68,540)
Capital losses not arising from BLAGAB[4]		(6,122) *(LAM03400)*
Net capital gains	(A1)	**236,455**
Capital losses		
BLAGAB losses arising		22,875
TCGA/S212 losses arising		45,665
		68,540

[4] These losses arises from the Long term business fixed capital and other.

LAM09000: Double Tax Relief

LAM09010	Double Tax Relief: Overview
LAM09020	Restriction of foreign tax credit proportionate to split of income on the 'commercial allocation' basis TIOPA2010/S97
LAM09030	Interaction of DTR and amounts set against total profits - management expenses and interest TIOPA2010/S52(2); CTA2009/S457 and S459
LAM09100	Restriction of relief to the corporation tax rate and interaction with policyholder tax rate TIOPA2010/S42
LAM09200	LAM09200 Credit relief restriction where profits calculated on trading basis: Overview and general principles TIOPA2010/S42 and TIOPA2010/S99
LAM 09210	Credit relief restriction where profits calculated on trading basis: First limitation TIOPA2010/S100
LAM09220	Credit relief restriction where profits calculated on trading basis: Second limitation TIOPA2010/S101
LAM09230	Credit relief restriction where profits calculated on trading basis: Meaning of total relevant expenses and total income TIOPA2010/103
LAM09240	Credit relief restriction where profits calculated on trading basis: Example
LAM09250	Companies with overseas branches
LAM09260	General limitations on credit relief: Pension business and minimisation of foreign tax TIOPA2010/S33

LAM09010: Double Tax Relief: Overview

Life insurance companies are entitled to relief for foreign tax suffered, subject to the rules in Part 2 of TIOPA2010 (see INTM160000). Foreign tax will generally be either:

- overseas tax on non-UK income, such as dividends, interest, rent etc., or
- tax paid in relation to profits of an overseas branch

This chapter references some of the general rules in Part 2 of TIOPA 2010 that need particular consideration for life companies as well as variations to those rules specific to insurance companies in TIOPA2010/S96 to S104.

The rationale for the differences and the main provisions to consider are:

Relating foreign tax to I-E profit and non-BLAGAB profit	Restriction of foreign tax credit proportionate to split of income on the 'commercial allocation' basis TIOPA2010/S97 LAM09050. Offset of expenses and interest in line with normal rules but INTM guidance on interest should be read as referring to CTA2009/388,389 and 391 re BLAGAB assets LAM09060
CT / Policyholder rate	Restriction of relief to the corporation tax rate; impact of policyholder tax rate TIOPA2010/S42 - the 'composite rate' LAM09100
Specific rules for s35 trade profits computations	General principles and ability to claim foreign tax partly as credit relief and partly as an expense in certain situations LAM09200 Specific restrictions to credit relief in trading computations to prevent credit either for tax suffered by policyholders or tax in excess of that related to trading profit (as opposed to total profit) LAM09210 to LAM09240. Relief for companies with overseas branches including those specific to insurance companies LAM09250 Pension business and principle of minimisation of foreign tax TIOPA2010/S33; LAM09260 Note: dividends are taxable in life insurers trading profit calculations and therefore foreign tax credits/relief may be due

An example calculation of double tax relief is explained at LAM09240 and this example is incorporated in the example tax computation in LAM08000.

LAM09020: Restriction of foreign tax credit proportionate to split of income on the 'commercial allocation' basis TIOPA2010/S97

Where an insurance company carries on more than one category of long-term business the credit relief for any particular category of business must not exceed the

amount of foreign tax attributable to that category of business. In practice, as from 1 January 2013, the only relevant categories are BLAGAB and non-BLAGAB

The foreign tax on any item of income or gain ("relevant income") attributable to a category of business is a fraction of the total foreign tax on the relevant income – TIOPA2010/S97(2). The fraction is:

RPRI/TRI

RPRI is the amount of the income attributable to a category of business

TRI is the total relevant income to which the foreign tax relates –TIOPA2010/S97(3).

The amount of relevant income referable to a category of business is to be determined in accordance with an acceptable commercial method TIOPA2010/S97A. The method must be consistent with that in FA2012/S98 (Income, losses and expenses LAM05020) or FA2012/S115 (trading apportionment rules – LAM05110). The methods adopted for FA2012/S98 and S115 must themselves be consistent with one another.

A single item of foreign investment income may be referable partly to BLAGAB and partly to non-BLAGAB. For the purpose of the DTR calculations the two parts are considered separately.

Ordinarily, the rules do not allow foreign tax on the same amount of income to be relieved partly as credit and partly as an expense. However where the income is attributed to the two separate categories of business, BLAGAB and non-BLAGAB, the relevant amounts may be treated as investment income in the former and trading profit in the latter. It follows that TIOPA2010/S31(2)(a) does not deny a deduction.

Where foreign tax is treated as an expense, it is an expense of the business in receipt of the relevant income and given as a deduction in the tax computation for that business's trade.

As well as BLAGAB and non-BLAGAB, it is possible that credit relief may also be available in the Long-term Business Fixed Capital and other computation.

LAM09030: Interaction of DTR and amounts set against total profits - management expenses and interest TIOPA2010/S52(2); CTA2009/S457 and S459

Life insurance companies may have four computations where DTR may be relevant:

- the BLAGAB I-E calculation
- the BLAGAB trade profit calculation
- the non-BLAGAB trade profit calculation
- the LTBFC and other income calculation

When allocation of income is necessary, it is carried out on a commercial allocation basis. In calculating DTR as expense or credit relief in the BLAGAB I-E, the normal rules apply for offset of expenses / management expenses and for interest. These are briefly summarised below to highlight aspects that may be of particular relevance to life insurance companies. More detail is included in the international manual.

Set off of expenses, including management expenses

The amount of foreign tax credited against Corporation Tax on any income must not exceed the Corporation Tax attributable to that income LAM09100. Where there are amounts deductible against profits of more than one description, TIOPA2010/S52(2) allows the company to decide how expenses are set off for the purposes of determining the CT charged on any particular item of income or gain. These rules take precedence over any other provisions, such as those in FA2012/S127.

This general rule applies to management expenses in the I-E computation as well as the trading computations.

Interest

The UK charge to tax on interest is by reference to the amount accruing, whereas foreign tax is deducted from the amount as it is paid. INTM167120 to INTM167320 set out the basis for determining how interest which has suffered foreign tax is identified for the purpose of determining credit relief in respect of that foreign interest.

Where securities are bought or sold between interest dates, sections TIOPA2010/S107 and S108 apply to all aspects of a life company's computations (INTM167210) to restrict tax credit relief to the tax referable to the company's period of ownership. Life insurance companies may engage in stock lending or repo transactions. TIOPA2010/109- 110 allows assets used in these transactions to continue to be treated as owned.

Where a life insurance company receives an amount of interest from which foreign tax has been deducted, the guidance in INTM applies. The guidance refers to carry back and carry forward of deficits within section CTA2009/457 or 459. These provisions should be read as referring to section CTA2009/S388, 389 and 391 where the interest arises on BLAGAB assets – TIOPA2010/S54(7) and 55(4) & (5).

LAM09100 Restriction of relief to the corporation tax rate and interaction with policyholder tax rate TIOPA2010/S42

The amount of foreign tax credited against Corporation Tax on income must not exceed the Corporation Tax attributable to that income. TIOPA10/S42(3) links to detailed rules for attributing Corporation Tax to income for this purpose where deductions from total profits (for example, charges or management expenses) are to be set off (LAM09030).

In cases where the FA2012/S102 policy holders' rate applies to part but not all of a company's relevant profits, when calculating the amount of corporation tax attributable to an amount of income or gain, the rate to be used is the 'composite' rate of corporation tax payable by the company.

Example:

A company receives foreign source interest of £1m net of 25% foreign tax. The mainstream rate of CT is 18%, and the policy holder rate is 20%. The relevant profits are 100,000 of which 20,000 are chargeable at the mainstream rate of 18%, and the balance at the policy holder rate of 20%.

The “composite” rate of CT chargeable on the interest is calculated as follows:

	Tax rate	Relevant profits	Tax
CT at mainstream rate	18%	20,000	3,600
CT at PH rate	20%	80,000	16,000
Total tax		100,000	19.600
Composite rate			19.6%

Credit for foreign tax is limited to 19.6%. This is regardless of any other restrictions on credit relief.

LAM09200: Credit relief restriction where profits calculated on trading basis: Overview and general principles TIOPA2010/S42 and TIOPA2010/S99

Where relief against foreign tax suffered is claimed by way of a credit against corporation tax, the credit relief claimed must not exceed the corporation tax attributable to the income (TIOPA2010/S42). In addition to this general restriction, TIOPA2010/S99 introduces further specific rules that limit the amount of credit for foreign tax where:

- an insurance company carries on any category of insurance business
- the trading basis is used to calculate profits chargeable to corporation tax in relation to the category of business
- the company has any income or gain where credit for foreign tax can be claimed

The further limitations are:

- the First Limitation, provided by TIOPA2010/S100 (LAM09220)
- the Second Limitation, provided by TIOPA2010/S101 (LAM09230)
- TIOPA2010/S99 does not apply to foreign tax charged on branch profits (LAM09250)

The general approach of section 99 is to look at the computation for each category of business and to prorate expenses and reliefs. In practice, since 1 January 2013, the categories of business are BLAGAB and non-BLAGAB. TIOPA2010/S104 applies section 97 and 97A (commercial allocation – see LAM09050) to each item of income or gain and the DT arrangements in order to find the fraction of the foreign tax attributable to each category of business.

Using subsidiaries to prevent the restrictions

TIOPA2010/S99(4) prevents a scheme or arrangement using a 75% subsidiary of an insurance company, which itself does not carry on insurance business, to circumvent the expenses limitation. It requires that the amount of corporation tax attributable to any item of income or gain arising to the subsidiary is to be found by setting off against

that item the amount of expenses that would be attributable to it if that item had arisen directly to the insurance company.

Relief partly by way of credit and partly as an expense

Section 99 provides exceptions to the TIOPA/S31(2)(a) rule that relief for foreign tax cannot be partly given by way of credit and partly as an expense in relation to the same income. Where the amount of credit available is reduced as result of applying the first and second limitations, the difference in the amount of tax may be treated as a deduction(TIOPA2010/S99(5)). If section 99(4) reduces the credit relief available then the difference in the amount of tax may be treated as a deduction in the 75% subsidiary (TIOPA2010/99(6)).

LAM09210: Credit relief restriction where profits calculated on trading basis: First limitation TIOPA2010/S100

The first limitation on credit relief reduces relevant income or gains on which foreign tax has been paid, by the amount of expenses attributable to the income (TIOPA2010/S100). Relevant income cannot be reduced below nil to create a loss or relief.

The main object of the first (expenses) limitation is to ensure that foreign tax is only creditable against corporation tax chargeable on the part of the trading profit which the relevant item of income has contributed to the overall pot.

The amount of expenses attributable to the relevant income is the appropriate fraction of the total relevant expenses (“TRE”) of the category of business for the period, and that fraction is provided at TIOPA2010/S100(3) as:

$$\frac{\text{RI = the relevant income}}{\text{TI = the total income of the category of business}}$$

Where:

> RI is the amount of the income or gain for the period referable to the category of business (before any reduction required by the first or second limitations) to which the foreign tax relates.
>
> TI is the total incomings less the total outgoings of the category of business for the period

The components of the calculation for both relevant expenses and TI are provided for in TIOPA/S103 (see LAM09090).

If the total income (TI) of the category is nil then TI becomes the total of all the relevant income of the company for the category concerned (TIOPA2010/S100(4)).

The First Limitation – Shortcut

Since both total relevant expenses and TI are wholly independent of the amount of income on which tax credit is allowable, or on the amount or percentage of foreign tax, it is possible to apply the first limitation to the totality of income and gains on which any foreign tax falls to be allowed as credit. However it may still be necessary to calculate the reduction for any particular item of income to test whether the foreign tax on that income exceeds the corporation tax attributable to the income as reduced by the first and second limitations. The reduction to be made will always be the same in percentage terms.

LAM09220: Credit relief restriction where profits calculated on trading basis: Second limitation TIOPA2010/S101

The expenses limitation (see LAM09210) only reduces the income by what might be regarded as direct expenses: primarily the outgoings represented by the liability to policy holders which may increase in proportion to the income received.

The second limitation ensures that foreign tax on relevant income is not creditable at all against corporation tax where there is no, or a very limited amount of trading profit. This could be due to the deduction of indirect expenses or set off of losses brought forward (TIOPA2010/S101).

The limitation applies where

- the amount of the relevant income after any reduction under the first limitation exceeds
- the relevant fraction of the profits of the category of business, after the set off of any brought forward losses

Where the limitation applies, the relevant income is further reduced (but not below nil) to an amount equal to that fraction of those profits (TIOPA2010/S101(1)).

The relevant fraction to be applied to the profit (TIOPA2010/S101(2)) is:

RI = the relevant income
The referable share of total relievable income and gains

Where:

RI is the amount of the income or gain for the period referable to the category of business (before any reduction required by the first or second limitations) to which the foreign tax relates.

The referable share of total relievable income and gains is the sum of all income and gains for the period referable to a particular category (before any reduction required by the first or second limitations).

Strictly, section 101 applies on an item by item basis, so that the credit relief in respect of any item is limited to the corporation tax on the proportion (the relevant fraction) of the trading profit that the item bears to the total of all the items in the computation that have borne foreign tax. However, in most cases a calculation using aggregate amounts will produce the correct answer. Items of income taxed at the same rate of foreign tax

can always be aggregated and there should be no problem where the trading profit is significantly larger than the total foreign income attributable to the category of business as limited by the first limitation. In other cases care will be required.

Any restriction to the amount of credit relief available against corporation tax under section 101 will increase the amount of foreign tax deductible as an expense. To avoid iteration the section 101 limitation, C, can in most cases be calculated as follows:

$$C = (P - B)/(1 - R)$$

Where:

R is the rate of corporation tax

P is the trading profit (or the relevant fraction of the profit) before any deduction for foreign tax other than that which can only be expensed

B is the foreign tax on the relevant income

LAM09230: Credit relief restriction where profits calculated on trading basis: Meaning of total relevant expenses and total income TIOPA2010/S103

Definitions of total relevant expenses and total income in TIOPA2010/S100 for the calculation of the first (expenses) limitation (see LAM09210) are given in TIOPA2010/S103.

Total relevant expenses (section 103 (5)) is the sum of:

- the claims incurred, net of reinsurance
- the changes in other technical provisions, net of reinsurance
- the change in the equalisation provision
- investment management expenses

unless the sum is a negative amount, in which case the total relevant expenses will be nil, and no expenses will fall to be deducted from the relevant income.

Total income (section 103(2)) is the excess of the sum of the incomings listed in section 103(3) over the sum of the outgoings in section 103(4).

The incomings in section 103(3) are

- earned premiums, net of reinsurance
- investment income and gains
- other technical income, net of reinsurance

The outgoings in section 103(4) are

- acquisition costs
- the change in deferred acquisition costs
- losses on investments

The amounts included for the purposes of sections 103(3) to 103(5) are the amounts taken into account for corporation tax.

Where any of the terms used in these subsections is a term used in the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008/Schedule 3/Part 1/section B (SI 2008/410 which relate to the profit and loss account format, the terms have the same meaning as in those regulations. This applies regardless of whether the company uses those regulations to produce its accounts.

LAM09240*: Credit relief restriction where profits calculated on trading basis: Example*

This example is based on the double tax relief computation in the example tax computation in LAM Chapter 8 and focuses on credit relief for non-BLAGAB foreign income.

TIOPA2010/S42 general limitation

Under the restriction in TIOPA2010/S42 the credit relief claimed in respect of foreign

A	B	C	D	E	F	G	H	I	J	K	L
Source	**Relevant income**	**Foreign tax**	**Rate**	**Foreign tax to 20.25 %**	**Excess foreign tax**	**Appropriate fraction of relevant expenses (TRE x RI/TI)**	**Income above expenses TIOPA 2010 s100**	**Relevant fraction of profits**	**Income restricted to profits TIOPA 2010 s101**	**Maximum creditable tax**	**Actual creditable tax**
Overseas shares	100	15	15%	15	0	67.37	32.63	(276)	0	0	0
Overseas preference shares	18,997	4,749	25%	3,847	902	12,798	6,199	(524)	0	0	0
Overseas debentures	283,800	2,838	1%	2,838	0	191,196	92,604	(7,740)	0	0	0
Total	302,897										0

income must not exceed the corporation tax attributable to that income. Table B3 from the example tax computation (below) splits relevant non-BLAGAB income into that from overseas shares and from overseas debentures, then shows the foreign tax paid (column C) on that income and the rate of foreign tax (column D). Focusing on the income from Overseas shares (i.e. relevant income of £100), as the foreign tax of £15 does not exceed the corporation tax attributable to that income (column E), there is no restriction under TIOPA/S42 (no excess tax in column F).

B3 – Foreign income - Non-BLAGAB

TIPOA2010/S100: First (expenses) Limitation

The items relevant to the calculation of total income for the purposes of the first (expenses) limitation (LAM09230), allocated on a commercial basis (and are not identifiable elsewhere in the computation), are:-

	Non-BLAGAB
Premiums	1,500,000
Investment income	500,000
Change in DAC	- 100,000
Expenses non-acquisition	- 45,000
Claims	- 1,235,000

Investment income includes the foreign income in respect of overseas shares of £100 in Table B3 above, on which foreign tax is £15.

Total relevant expenses (TRE) = £45,000 (expenses) + £1,235,000 (claims) = £1,280,000

The appropriate fraction per TIOPA2010/S100 is:

$$\frac{Relevant\ income(£100)}{TI = £1{,}500k\ (prem) + £500k(inv\ inc) - £100k(changes\ in\ DAC)} = \frac{100}{1900k} = 0.005\%$$

The expenses attributable to relevant income is therefore TRE x the appropriate fraction, £1,280,000 ×0.005= £67.37 (shown in column G of table B3 above)

The amount of relevant income as reduced by the first (expenses) limitation is £32.63 (i.e. £100-£67.37), which is shown in column H.

TIOPA2010/S101: Second Limitation

The second limitation applies where:

- the amount of the relevant income after any reduction under the first limitation exceeds
- the relevant fraction of the profits of the category of business, after the set off of any brought forward losses

15.

Where this applies, the relevant income is further reduced (but not below nil) to an amount equal to that fraction of those profits (LAM09220).

The relevant fraction applied to the profit is:

RI = the relevant income
The referable share of total relievable income and gains

From table B3 above, RI is £100 in respect of non-BLAGAB income from overseas shares.

The referable share of total receivable income and gains, (not identifiable from the example computation) is £400,000.Therefore the relevant fraction is:

£100/£400,000= 0.025%

From A5 in the example computation in Chapter 8, there is a non-BLAGAB trade loss of £5,605.

The relevant fraction of the profit is 0.025% x £(5,605)= £(140)

As the relevant income after the first limitation, £32.63, exceeds the relevant fraction of profits, £(140), RI is reduced to nil. Therefore, the amount of creditable tax in Columns K and L is also nil.

LAM09250: Companies with overseas branches

A company can claim credit for foreign tax payable on profits, income or chargeable gains from sources within another state against any UK tax computed by reference to the same profits, income or chargeable gains.

Where foreign tax has been charged on profits of long-term business carried on in an overseas territory through a permanent establishment (PE) there, the rules explained in INTM163030 to INTM163050 will apply, subject to TIOPA2010/S96.

Profits of the PE and attribution of capital

INTM163030 requires calculation of profits attributable to each PE in order to determine the amount of CT applicable to the PE, and so set the limit for double taxation relief. Where a life insurance company carries on business through two or more PEs it may be difficult to establish with accuracy the profit of any particular PE. Allocation of premiums, claims, expenses and liabilities to a particular PE should not be problematic.

Attribution of the investment return may be more difficult. As outlined in INTM288030, an insurance company will hold assets to back insurance liabilities (technical provisions) and to meet capital requirements to support the risks insured. The attribution of the investment return on assets supporting the insurance business of a PE is an important component in calculating the profit attributable to a PE of an insurance company. The attribution of profits to insurance PEs is discussed in more detail in the General Insurance Manual at GIM10210.

Non-BLAGAB computations – restriction of credit relief

TIOPA2010/S96 restricts the credit relief due in a non-BLAGAB trade profit computation to ensure that credit relief is only given for tax which will not be borne by policyholders i.e. is tax on shareholders profits. The investment return on non-BLAGAB reserved as a policyholder liability does not generate a net UK taxable profit liability and accordingly the tax credit against the trade profit calculation is restricted to reflect this.

The provision works by restricting on a country by country basis the amount of the foreign tax which qualifies for relief. Credit relief for the tax imposed by the overseas territory concerned must not exceed the greater of:

- tax which is charged by reference to local profits (TIOPA2010/S96(4)(a))

  This means a charge on profits which allows a deduction for policyholder liabilities similarly to a UK trading profit calculation. This limit will therefore only

bite where there are two (or more) separate foreign tax charges, one of which is on trading basis lines and one of which is not.

- the shareholders’ share of the total tax (TIOPA2010/S96(4)(b))

That share is a fraction of the foreign tax A/B (TIOPA2010/S96(5))
16.
where:

- A is the relevant UK-taxable profits before giving relief for any foreign tax deducted from income under TIOPA2010/S96(7)

- B is a figure which gives a measure of the company’s total investment return from the category of business. That figure is the excess of its receipts, excluding premiums and recoveries under reinsurance contracts, over its expenses

If there is no excess in B, or if the profits in B are greater than any excess, the whole of the foreign tax is the shareholders' share. If there are no profits, none of the foreign tax is the shareholders' share (TIOPA2010/S96(6)).

If credit relief is restricted by TIOPA2010/S96 then TIOPA2010/S31(2)(a) does not prevent relief both by way of credit and, for the foreign tax restricted, by way of deduction from income (TIOPA2010/S96(7)(2)(a)).

LAM09260: General limitations on credit relief: Pension business and minimisation of foreign tax TIOPA2010/S33

Relief is limited to the lowest possible rate of foreign tax. TIOPA2010/S33 requires all reasonable steps to minimise the tax payable in the other territory. Where there is a double taxation agreement (DTA) then it is assumed that all appropriate claims are made under the DTA. Credit relief is not available for any tax suffered by a company in excess of the treaty rate – see INTM161250.

This is particularly relevant to life assurance companies which carry on pension business.

Under a number of DTAs the rate of withholding tax on dividends can be reduced or eliminated in some cases where the person claiming is a “pension scheme”. The current OECD model treaty from 2014 does not contain a definition of pension scheme. However a number of treaties, protocols to existing treaties and exchanges of letters have dealt with the definition of pension scheme. These include:-

- UK - US treaty (24 July 2001)
- UK - Japan treaty (2 February 2006)
- UK - Switzerland treaty (Protocol of 26 June 2007)
- UK - Norway treaty (14 March 2013)
- UK - Spain treaty (14 March 2013)

Under some treaties and in certain circumstances, life insurance company pension business can qualify as a pension scheme. See INTM157020 for links to the latest UK tax treaties.

LAM10000: Reinsurance

LAM10010 Introduction to the taxation of life reinsurance

LAM10020 What is reinsurance?

LAM10030 Types of life reinsurance contracts

LAM10040 The commercial rationale for reinsurance

LAM10050 Accounting for reinsurance arrangements: ‘deposit back’ and ‘funds withheld’

LAM10100 The taxation of reinsurance companies: overview

LAM10110 Reinsurance of BLAGAB: background to FA2012/S57(2)(e) and S90

LAM10200 Reinsurance: excluded business and the I-E charge FA2012/S57 - contracts between connected parties entered into on or after 1st June 2018: The Insurance Companies (Taxation of Re-insurance Business) Regulations 2018/538 Regulation 5

LAM10210 Reinsurance: excluded business and the I-E charge FA2012/S57 : life assurance business linked to UK land: The Insurance Companies (Taxation of Re-insurance Business) Regulations 2018/538 Regulation 6

LAM10220 Reinsurance of BLAGAB: Imputed investment return on the cedant- FA2012/S90 The Insurance Companies (Taxation of Re-insurance Business) Regulations 2018/538 (contracts entered into on or after 1st June2018)

LAM10230 Tax treatment of the cedant: Prescribed arrangements not subject to imputed return under FA2012/S90: The Insurance Companies (Taxation of Re-insurance Business) Regulations 2018/538 regulations 8-12

LAM10240 Calculation of imputed investment return FA2012/S90 and The Insurance Companies (Taxation of Re-insurance Business) Regulations 2018/538 Schedule ‘Investment Returns’

LAM10250 FA2012/S57 investment return where risk in respect of policy or contract is reinsured between connected parties (for contracts entered into after 31st December 2012 and before 1st June 2018)

LAM10260 FA2012/S90 investment return where risk in respect of policy or contract is reinsured between unconnected parties (or contracts entered into after 31st December 2012 and before 1st June 2018)

LAM10300 FA2012/S65 The taxation of BLAGAB group reinsurers

LAM10010: Introduction to the taxation of life reinsurance

Where all of a company's life insurance business consists of reinsurance business the normal rule is that its profits are assessable as trading income under CTA2009/S35. Taxing reinsurance as a trade reflects the nature of the business which is confined to reinsuring risks from other insurers.

However where a company taxed under I-E reinsures the investment risks of its BLAGAB policies there are special rules in place to prevent erosion of the I-E tax base. In the absence of those provisions an insurer writing BLAGAB could, for example, arrange to reinsure BLAGAB to a connected company that is not within the I-E regime or a non UK company not within the charge to UK tax. If the assets backing the liabilities pass to the reinsurer there may be no (or reduced) investment return in the cedant to which the I-E basis can apply.

A company may also reinsure its pension business but, as that falls outside I-E, these special rules do not apply.

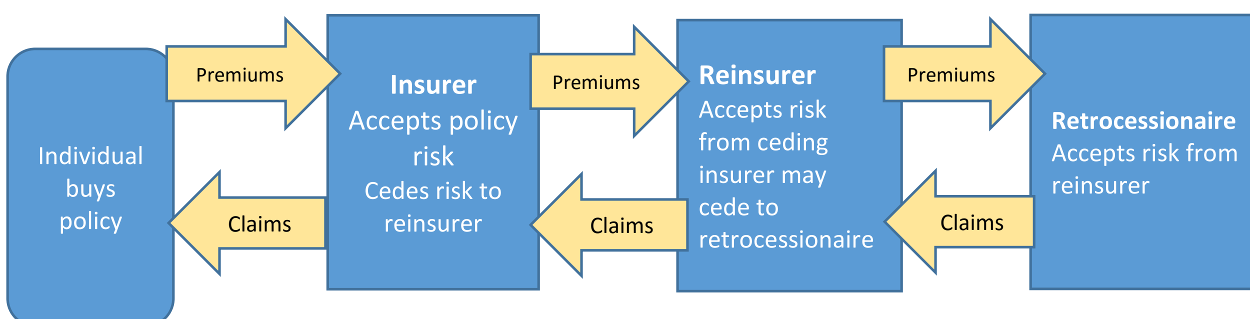
This chapter covers:

- a brief overview of commercial reinsurance business LAM10020-10040
- an explanation of the special rules related to reinsurance of BLAGAB that may apply to both reinsurers and insurers.LAM10100-10260
- a reference to the treatment of BLAGAB group reinsurers LAM10300

A basic understanding of reinsurance and its commercial function is important to put in context the special rules set out here. It is also helpful in the context of assessing tax risk, particularly in relation to BLAGAB reinsurance and cross border reinsurance transactions. Fuller explanations of commercial reinsurance are available on external websites.

LAM10020: What is reinsurance?

Reinsurance provides insurance for insurers. It is an agreement which enables primary insurers to manage their risks and limit their liabilities in return for the payment of a premium. A reinsurance company is a wholesale seller of insurance to a primary insurer (the 'cedant') who offers insurance to the end customer (the policyholder). A reinsurance company may also enter into a further reinsurance with another reinsurer which spreads the original risk across the market. This is known as a 'retrocession'.



Insurers benefit from reinsurance by obtaining capital advantages, reducing the amount of capital held by the business, and protection from underwriting risk. This improves the capacity of the insurer to accept further risks which might otherwise be limited by the amount of solvency capital they hold. Reinsurers are able to diversify

their business both geographically and in terms of the types of business they accept and that can give rise to capital benefits which cannot be enjoyed by the primary insurer. In this way reinsurers can reduce their overall risk exposure, and therefore the amount of regulatory capital they hold, because adverse outcomes from one set of risks can be offset by a more positive outcome from other risks which are not correlated.

Reinsurers need to have a strong capital base to attract business and the majority are rated at least ‘A’ by the ratings agency Standard and Poor’s.
Reinsurance can also occur where the counterparty is a member of the same group of companies as the primary insurer. Although intra-group reinsurance does not give rise to risk transfer outside the group, capital benefits for regulatory and rating agency purposes can still be obtained through, for example, risk diversification. Where the reinsurer is located in a low tax jurisdiction corporation tax mitigation can also be a significant factor driving such arrangements.

LAM10030: Types of life reinsurance contracts

Reinsurance is either:

- facultative (the reinsurance of an individual risk, negotiated separately for each contract)
- treaty (for a period of time, with an obligation on the cedant to cede and the reinsurer to accept the specified risks)

Both categories of reinsurance can be arranged on either a proportional or a non-proportional basis. Proportional reinsurance can either be quota share or surplus and the parties share the premiums and losses between them according to a contractually defined ratio. For quota share treaties, for example, the reinsurer accepts a percentage of every policy covered in the treaty. Under non-proportional reinsurance a reinsurer pays a predetermined proportion of the claims which fall between an agreed lower and upper limit of cover. This is known as “excess-of-loss”. “Stop loss” reinsurance works in a similar way and protects the insurer against catastrophic losses by assuming risks after a certain threshold is reached.

Reinsurance arrangements entered into by general insurers (writing property and casualty business) are typically renewable annually, and many roll over automatically with annual break clauses. Such transactions dominate the reinsurance industry. Their tax treatment is described at GIM8000 onwards.

Life insurance risks are fundamentally different because:

- they are very long-term and
- many life products consist of investments which have only a small element of insurance risk
- they may involve ‘deposit back’ or ‘funds withheld’ arrangements LAM10050

Life reinsurance may in some cases relate wholly to insurance risk for example, mortality or disability risk and can disaggregate risks within the policies being reinsured.

LAM10040: The commercial rationale for reinsurance

Reinsurance is an important risk management tool for insurers enabling reduction of risk and may be driven by a number of commercial factors such as:

- reducing exposure to specific risks
- to increase capital available to write new business
- to access expertise in the reinsurer
- the price of reinsurance may be attractive as reinsurers may have lower capital requirements for the same business due to their scale and spread of risks
- reinsurance in advance of a transfer of business, explained below

This is not an exhaustive list of drivers but indicates some that may apply.

An insurance business transfer scheme under Part 7 of the Financial Services and Markets Act 2000 ('FSMA') enables an insurer to transfer policies at a specific time and date to another insurer without the need to obtain the permission of individual policyholders. Court approval is required and that can take time, typically 12-15 months, as policyholders need to be notified and substantial actuarial input is required particularly in the case of life businesses.

Therefore, where an insurance business is acquired from a third party, it is quite common for the economic benefit of the business to be immediately transferred to the ultimate recipient by means of a reinsurance contract. The reinsurance is then collapsed when the court approved transfer occurs. This can also occur where an insurance company is acquired from a third party and the business is then transferred across to another group insurer. The taxation of Part 7 transfers is dealt with in LAM chapter 13.

LAM10050: Accounting for reinsurance arrangements: 'deposit back' and 'funds withheld'

In a quota share arrangement the reinsurer assumes part of the risk and is entitled to a share of the premium and pays a share of claims. The gross premium will be shown in the insurer's accounts, with the reinsurance shown separately, to arrive at a premium net of reinsurance. There is no contractual relationship between the policyholder and reinsurer, only between the insurer and the reinsurer.

Reinsurance arrangements, which can last for decades in the case of life business, carry a significant credit risk for the primary insurer who is exposed to loss if the counterparty fails to meet its contractual obligations. The reinsurer's credit rating, which is a measure of financial strength, reflects that credit risk.

One way in which cedants manage credit risk is to enter into arrangements which mean that the insurer retains control over the assets backing the policy described as:

- 'deposit back' :an amount of assets deposited with the ceding company as collateral to cover the insurance liabilities. That can be substantial where the premium consists of the assets used to back the insurance liabilities
- 'funds withheld' the ceding company withholds the premium due to the reinsurer and holds the assets in a separate account

Where these arrangements give rise to investment income in the hands of the cedant that has important tax consequences for the operation of I-E because the cedant remains within the I-E charge and there is no need to calculate an imputed return. (See LAM10100-10260).

In practice there may not be separate payments of premium, claims and investment return because amounts will be netted off and accounted for periodically by means of a single payment.

LAM10100: The taxation of reinsurance companies: overview

Where company reinsures life assurance business the normal rule is that the reinsurer treats it as non-BLAGAB which is charged to tax as trading income under CTA2009/S35. Taxing reinsurance as a trade reflects the nature of the business which is confined to reinsuring risks from other insurers where no business is directly written by the reinsurer itself.

However where a reinsurer reinsures BLAGAB business, this business is potentially within the scope of the S68 I-E charge. There are also 'Insurance Special Purpose Vehicles' ISPVs where BLAGAB reinsurance may trigger the I-E provisions. These are summarised below:

Reinsurers with no 'excluded business'	Profits assessable as trading income CTA2009/S35 FA2012/S57(e) takes re-insurance of life assurance business other than excluded business out of the BLAGAB definition – non-BLAGAB will be taxed on trading basis, as financial trader
Reinsurers with BLAGAB 'excluded business' as defined by regulations	Potential FA2012/S68 charge on cedant on imputed investment return: FA2012/S68 charge for reinsurer unless substantially all non-BLAGAB -pre 31 May 2018 defined in SI1995/1730
BLAGAB Group reinsurers - ISPVs	FA2012/S68 charge for reinsurance ISPV writing BLAGAB 'excluded business' FA2012/S65(4) unless substantially all non-BLAGAB LAM10300

LAM10110: Reinsurance of BLAGAB: background to FA2012/S57(2)(e) and S90

A UK reinsurer is brought within the scope of I-E by virtue of S57(2)(e) if the business falls within the definition of 'excluded business'. The provision is designed to protect the I-E charge in certain circumstances, essentially where the cedant is not taxed on the related investment return under I-E.

In other cases, for example where the reinsurer is not within the charge to UK tax, the cedant may be subject to the provisions of FA2012/S90 and an imputed investment return may be applied.

Regulations implemented under the powers in S57(3) define excluded business and under S90(4) and (5) define rules for taxing investment return in the insurer as follows:

- For contracts entered into on or after 1st June 2018 'The Insurance Companies (Taxation of Re-insurance Business) Regulations 2018' [(SI2018/538)] LAM10200
- For contracts entered into on or after 1st January 1995 but before 1st June 2018 Insurance Companies (Taxation of Reinsurance Business) Regulations 1995 (SI1995/1730). LAM10300

Note that following the introduction of the FA2012 regime, the 1995 regulations were not repealed and continued to apply to business written up to 1st June 2018 FA2012/S57 and S90. That follows from the transitional rules in FA2012/SCH17/PARA36. This guidance does not consider the effect of the primary legislation which applied prior to FA2012.

The definition of excluded business is the key consideration. FA2012/S57(2) defines BLAGAB as anything other than the categories of business listed, which at S57(2)(e) lists as not being BLAGAB:

> 'reinsurance of life assurance business other than excluded business'

Therefore provided the reinsurance of BLAGAB is not 'excluded business' all of the profits will be subject to the normal corporation tax rules and no special rules apply. As a financial trader, note that dividends are taxable and this is confirmed by FA2012/S111.
However, where a reinsurer writes excluded business, it is treated as BLAGAB and the reinsurer must apply the I-E rules to the income and gains relating to the business reinsured unless FA2012/S67 applies.

Historically, reinsurers would aim to avoid falling into this category if at all possible due to the additional complexity of applying the I-E rules. The regulations introduced in 2018 are intended to enable reinsurers in this situation to stay outside the scope of the I-E charge where the insurer is subject to I-E on the business reinsured. Note that detailed guidance on the rules in SI1995/1730, amended by SI2003/2573, can be found at old LAM4D.101 onwards and a short summary is provided in LAM10250.

LAM10200: Reinsurance: excluded business and the I-E charge FA2012/S57 - contracts between connected parties entered into on or after 1st June 2018: The Insurance Companies (Taxation of Re-insurance Business) Regulations 2018/538 Regulation 5

The Insurance Companies (Taxation of Re-insurance Business) Regulations 2018 apply to reinsurance arrangements entered into on or after 1st June 2018 and replace the 1995 regulations which continue to apply to arrangements before 1 June 2018. Reinsurance will be excluded business and taxed under S68 on the reinsurer if:

- The cedant and reinsurer are members of the same 90% group (reg 5(2))
- The cedant is UK resident or has a UK permanent establishment within the charge to corporation tax in respect of the business being reinsured (reg5(3))
- The business being reinsured is BLAGAB (reg 5(4))

There are two exceptions, where the reinsurer will not be within the S68 charge as the business will not be 'excluded business':

- Reg 5(5) where the reinsurance is a 'non investment risk arrangement' where the risks reinsured do not include investment risk. For example, mortality risk which does not give rise to investment return
- Reg 5(6) where the cedant is effectively taxed under S68 on the investment return, meeting condition 2 in Reg 8(3) (see LAM10230). In practice, for intragroup reinsurance, Reg 5(6) allows the reinsurer to avoid the complexity of bringing the I-E charge into the reinsurer's tax computation where the insurer remains within S68 on the investment return on the backing assets

These regulations are subject to the application of the anti-avoidance provisions in Reg 13(2).

LAM10210: Reinsurance: excluded business and the I-E charge FA2012/S57 : life assurance business linked to UK land: The Insurance Companies (Taxation of Re-insurance Business) Regulations 2018/538 Regulation 6

In certain limited circumstances, life reinsurance will be 'excluded business' and taxed as BLAGAB on the reinsurer where the cedant is not within the S68 charge.

Overseas life assurance business 'OLAB' is listed in S57 as not being BLAGAB. OLAB is defined in FA2012/S61 and in regulations SI2000/2089 and SI2007/2086. The OLAB category is intended to exclude, business written with non UK policyholders from the I-E charge. More detail on the definition of OLAB is in LAM01000.

Regulation 6 brings into the definition of excluded business, and hence into the BLAGAB I-E charge on the reinsurer, business where:

- the cedant is not UK resident or chargeable to tax on a permanent establishment
- the business is not OLAB (i.e. it is taken out of OLAB by the OLAB regulations) and
- the benefits under the policy are determined by reference to the value of matched assets consisting wholly or mainly of UK land

17. This is intended to protect the tax charge on income and gains from UK land.

“land” includes:

- buildings and other structures
- land covered with water
- any estate, interest, easement, servitude, right or licence in or over land

LAM10220: Reinsurance of BLAGAB : Imputed investment return on the cedant- FA2012/S90 The Insurance Companies (Taxation of Re-insurance Business) Regulations 2018/538 (contracts entered into on or after 1st June2018)

Section 90(1) and (2) provide that, where an insurance company reinsures any BLAGAB business (including any risk which is part of a BLAGAB policy), the cedant is charged under S68 on an imputed investment return subject to the exclusion in FA2012/S90(5). This protects the I-E position where, for example, the reinsurer is outside the scope of UK taxation.

The method of calculation of the imputed amount is set out in the schedule to SI2018/538 (see LAM10240). The charge will not apply if:

- the arrangements fall within the definition of prescribed arrangements in regulations 7-11 This means that where S68 applies to the reinsurer, or the cedant (in respect of the backing assets), or a UKPE is within S68 the provisions of s90 are disapplied. (see LAM10230)
- reinsurance arrangements only include negligible amounts of BLAGAB or where the cedant is not subject to S68 by virtue of S67 i.e writing ‘substantially all non-BLAGAB – regulation 12

In practice, many BLAGAB reinsurance arrangements are likely to be excluded from the operation of section 90 by these provisions.

All such exclusions are subject to an anti-avoidance provision in regulation 13 where one of the main purposes of the reinsurance is to reduce the I-E charge. The exception to this is regulation 13(3) where the reinsurance is between two UK connected companies within regulation 5.

Additionally, there are provisions to ensure the transferee stands in the shoes of the transferor in a transfer of business which includes BLAGAB reinsurance and the transferor was subject to the imputed charge in S90. (Regulation 14).

LAM10230: Tax treatment of the cedant: Prescribed arrangements not subject to imputed return under FA2012/S90: The Insurance Companies (Taxation of Re-insurance Business) Regulations 2018/538 regulations 8-11

FA2012/S90 provides the authority for regulations governing the scope of the S90 imputed return. These are in SI2018/538 /regulations 8-11 which defines ‘prescribed arrangements’ to be excluded from the S90 charge.

Prescribed arrangements regulations 8-11	
Regulation 8(2) Excluded business (group companies)	Reinsurer taxable in the UK as the business is within reg 5 - cedant will not be taxed under S90, avoiding a double charge Note that if cedant falls within Reg8(3) business will not be 'excluded business' per reg 5(6).
Regulation 8 (3) Cedant taxed S68	Investment return on assets backing the business taxable in the cedant therefore S90 will not apply to prevent double charge – see also below
Regulation 9 Reinsurer in EEA	Exclusion from charge where reinsured intra-group and reinsurer is taxed on equivalent basis in an EEA state
Regulation 10 Non-investment risk	This takes out reinsurance where there is effectively no shifting of policyholder investment income as no risks relate to investment
Regulation 11 Protection and immediate needs annuities	Carves out from S90 charge pre 2013 protection business which is BLAGAB, as this does not relate to investment risk. Reinsurance of immediate needs annuities is also excluded from S90
All of these exclusions from S90 subject to anti-avoidance in Regulation 13	

Regulation 8 effectively means that there is no imputation of income under S90 where either the reinsurer or the cedant is already charged to I-E tax on the related investment income.

Regulation 8(3) can apply where there is a deposit back arrangement. Assets are deposited, or lent back, to the ceding company as collateral to cover the insurance liabilities. Under those circumstances the cedant is likely to reflect the debits and credits arising from the assets in their GAAP accounts. In that case, they would include the investment return on the deposited back assets in their I-E profit computation under the normal I-E rules.

So, provided assets deposited back are genuinely those that back the liabilities under the reinsured business, the reinsurance will be a 'prescribed arrangement' not subject to S90. A funds withheld arrangement may bring a similar result – where the insurer retains the assets rather than having a 'deposit back'. Nevertheless if the deposit back, or funds withheld, arrangement is structured so that amounts are due by the cedant which would be deductible in the I-E calculation, for example where the deposit back is itself a loan relationship, then Regulation 8(3) cannot apply.

Regulation 8(2) will apply where the reinsurer is already within the I-E charge.

LAM10240: Calculation of imputed investment return FA2012/S90 and The Insurance Companies (Taxation of Re-insurance Business) Regulations 2018/538 Schedule 'Investment Returns'

The regulations separate out the ongoing annual calculations for continuing polices and calculations where policies cease in the cedants accounting period (APC). FA2012/S91(4) requires calculations on a policy by policy basis and the regulations follow this approach.

Continuing policies

For continuing policies the amount of income treated as accruing to the cedant is calculated by the imputed return formula in paragraph 8 of the schedule (SI2018/538/Para 2). A factor, equivalent to the average rate of return on UK 5 year gilts for the APC plus 4%, is applied to the average amount of liabilities which relate to the reinsurance in the accounting period ((SI2018/538/schedule/Para 8).

Ceasing policies and end of reinsurance arrangement

Where an individual policy which is the subject of the reinsurance ends within an accounting period, or the reinsurance arrangement itself ends, there is a true up to the actual amount of the investment income arising to that policy across the period of the reinsurance.

	True up calculation	
Step 1	Imputed investment return accrued to date of cessation on the policy	X
Step 2	Calculate the investment income which would have been chargeable to tax if the reinsurance had not been entered into	Y
Step 3	If X greater than Y treat difference as a loss under S91(6) If X less than Y treat difference as additional 'I'	
Applies to ceasing polices in each APC and in APC when reinsurance arrangement ends		

If there is an excess charge it is treated as income referable to BLAGAB and is brought into account in the I-E calculation as income in Step 1 of FA2012/S73. If it is a deficit then it is carried forward as a loss under FA2012/S91(6) offset against amounts in future periods chargeable under S90.

This approach fulfils the requirement in FA2012/S91(4) for a policy by policy reconciliation but enables a view of the whole arrangement to be taken at the end of a reinsurance arrangement.

However it is possible that insurers may not always be able (or willing given the practical difficulties) to calculate the actual investment return that would have been subject to I-E, in respect of individual ceasing policies on an annual basis (Step 2 of the true up calculation). In those circumstances the imputed return will continue to be applied across the whole period of the reinsurance.

In the accounting period of the cedant 'APC' in which the reinsurance arrangements comes to an end, where the cedant can provide evidence of what the actual investment return taxed under I-E would have been, the cumulative imputed return can be adjusted in that final APC. That applies to both the per policy calculation and the true up necessitated by the end of the reinsurance. As reinsurance arrangements are

generally bespoke it is difficult to specify what evidence might meet the test of being evidence which satisfies the officer of HMRC. In practice, reasonable explanations with supporting accounting or actuarial evidence should be accepted.

LAM10250: FA2012/S57 investment return where risk in respect of policy or contract is reinsured between connected parties (for contracts entered into after 31st December 2012 and before 1st June 2018)

The SI1995/1730 regulations, which were replaced in 2018, sought to relieve reinsurers of the need to operate the I-E rules even where some of the business they reinsured was BLAGAB business (or perhaps a component of BLAGAB business). This principle, which has been carried into the SI2018/538 provisions, has important practical consequences in that reinsurers do not have to operate the I-E rules and can avoid the additional tax complexity which would otherwise result
.
The exception to this is where the business that is being reinsured is ‘excluded business’. ‘Excluded business’ is defined by the regulations in SI1995/1730 that support section 57 and encompass certain ‘intra-group’ reinsurance arrangements. If the business that is being reinsured is ‘excluded business’ then it will fall within the definition of BLAGAB. As a result the profits of that business will fall within the I-E charge to tax in FA2012/S68 and will not be taxed in the reinsurer’s trade profits under CTA 2009/S35. The exclusions are in regulations 11 and 12 of SI1995/1730 and there is guidance at old LAM 2.36 and 9.25. This guidance describes the pre-FA2012 position and needs to be read with appropriate modifications as applying to FA2012/S57.

However the potential loss of I-E tax is not just limited to intra-group arrangements. Third party arrangements can also lead to a loss of tax. If an independent reinsurer does not have to meet the cost of paying tax on policyholder returns it can still be economically viable for a BLAGAB insurer to reinsure on arms-length terms to a reinsurer, avoiding the I-E charge on the investment return. And the reinsurer could be outside the charge to UK corporation tax with no possibility of applying the I-E basis.

This vulnerability is addressed by FA2012/S90 (see LAM10260).

LAM10260: FA2012/S90 investment return where risk in respect of policy or contract is reinsured between unconnected parties (or contracts entered into after 31st December 2012 and before 1st June 2018)

FA2012/S90(1) and (2) provide that, where an insurance company reinsures any BLAGAB business (including any risk which is part of a BLAGAB policy), the cedant has imputed to it the investment return that is accruing on that policy. The method for calculating the investment return to be treated as accruing to the cedant insurer under section 90, before 1st June 2018, is set out in regulations 1 to 8 of SI1995/1730. The methodology for calculating the imputed return is complex and there is detailed guidance at old LAM 4D.102 onwards. However the need to adopt the practical approach described at old LAM 4D.104 still applies.

Under section 90(3) this imputed return is treated as income referable to BLAGAB and is brought into account in the I-E calculation as income in Step 1 of FA2012/S73.
There are several exclusions to the operation of FA2012/S90 and these are set out in SI1995/1730/ regulations 9 and 10. The main exclusions are:

- Where the reinsurer is within the charge to UK I-E tax and the parties are members of the same group.
- Where the reinsurer is located within the EEA, has no UK branch and is taxed on the equivalent of an I-E basis
- Where the risk being reinsured is only mortality or morbidity risk and doesn't generate an investment return
- Policies made and reinsured before 29 November 1994 which are grandfathered.

The exclusions are fully set out in the guidance at old LAM 4D.111A to 4D.115 which should be consulted if necessary.

Section 90 removes the vulnerability that arises where BLAGAB is reinsured as the requirement to impute the investment return on the reinsured policies or contracts, and to include this in the cedant insurer's I-E charge, closes the gap that would otherwise exist and protects the integrity of the I-E regime.

Section 90(6) switches off the imputation rule where both the reinsurance arrangement and the policies or contracts that are being reinsured were entered into before 29 November 1994.
Detailed guidance on the rules in SI1995/1730, which were amended by SI2003/2573, can be found at old LAM 4D.101 onwards and are not reproduced here. The references are to TA1988/S442A which is the predecessor to FA2012/S90.

LAM10300: FA2012/S65 The taxation of BLAGAB group reinsurers

Following the coming into force of the EC Reinsurance Directive, in 2007, a company which only carries on reinsurance business may be authorised as an Insurance Special Purpose Vehicle (ISPV). ISPVs are defined in FA2012/S139(1) as undertakings which assume risk from insurers or reinsurers which are fully funded by the proceeds of debt or another financing mechanism. This follows the definition adopted by the FCA at INSPRU 1.6.2.

Although this definition clearly references the use of ISPVs as securitisation vehicles the FCA has confirmed that it is not limited to that category. What distinguishes ISPVs from other reinsurers is that they are fully funded to meet their reinsurance liabilities and therefore are not exposed to the same insurance risk as ordinary reinsurers. There is no reason why a company which provides reinsurance to other group companies cannot be an ISPV if it falls within the definition. Indeed there have been instances where group reinsurers have been authorised as ISPVs.

BLAGAB group reinsurers are defined in FA2012/S65(4) as persons who carry on BLAGAB or reinsure BLAGAB business which is excluded business under FA2012/S57(2)(e). Only ISPVs which fall within this definition are considered to be an 'insurance company' for the purposes of the FA 2012 provisions. That ensures that they are within the charge to tax under I-E.

Securitisation ISPVs and non-BLAGAB group reinsurers are not considered to be insurance companies for the purposes of FA 2012/ Part 2. The taxation of securitisation companies which securitise financial assets is governed by The Taxation of Securitisation Companies Regulations 2006 (SI 2006/2396). An ISPV group reinsurer which only (or substantially only) writes non-BLAGAB business is taxed on

its trade profits and the insurance company rules in Part 2 of FA2012 do not apply to it.

LAM11000: Long-term Business Fixed Capital

LAM11010 Long-term business fixed capital: overview: FA2012/S137

LAM11020 Long-term business fixed capital: background and purpose: FA2012/S137

LAM11030 Long-term business fixed capital: meaning of long-term business fixed capital: FA2012/S137

LAM11040 Long-term business fixed capital: structural assets: FA2012/S137(3)

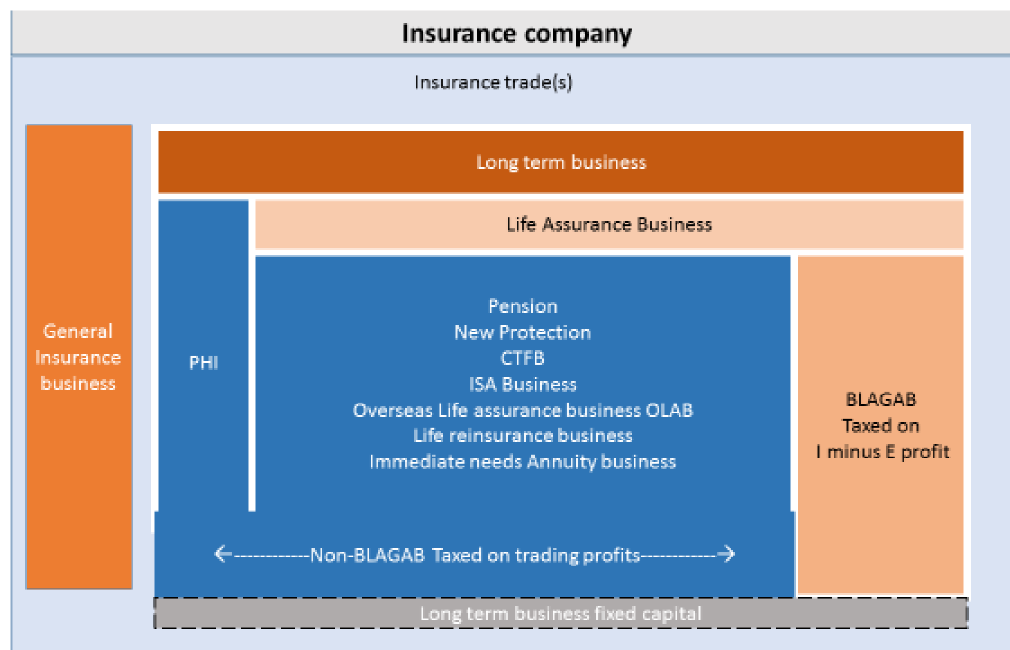
LAM11050 Long-term business fixed capital: grandfathering: FA2012/SCH17/PARA35 and FA2012/S137

LAM11060 Long-term business fixed capital: tax treatment: FA2012/S137 and FA2012/S122

LAM11070 Assets and liabilities not part of the life insurance business

LAM11010: Long-term business fixed capital: overview: FA2012/S137

The division of assets in a life insurance company is illustrated in the diagram below:



The long-term business rules for BLAGAB and non-BLAGAB LTB do not apply to:

1) General insurance business (LAM11070);
2) Assets forming part of the long-term business fixed capital (LTBFC) (LAM11030);
3) Assets which are not held for the purposes of the insurance trade(s) (LAM11070)

The assets in items 2 and 3 above will normally feature in the non-technical account in the company's financial statements where these are prepared under UK GAAP.

LAM11020: Long-term business fixed capital: background and purpose: FA2012/S137

Background

FA2012/S137 introduced the concept of a life insurance company having long-term business fixed capital (LTBFC) where the company holds long-term business assets which are structural to the business. The legislation at FA2012/S137 takes effect from 1 January 2013.

Prior to 2013, assets reported in the regulatory returns as 'other than for long-term business assets' – referred to as 'the shareholder fund'- were, apart from a few exceptions, excluded from the calculation of trade profits. In contrast, movements in asset values within the long-term fund, and the income arising from them, were included in trade profits. A limited exception was introduced by FA1989/S83XA which treated shares, debts and loans in insurance dependants as structural assets not giving rise to a trading receipt or expense. That was necessary because some insurers held shares in subsidiaries in their long-term fund and it was inappropriate to include the profits and losses in trading income because they were recognised as being capital assets.

FA1989/S83XA was also introduced as an anti-avoidance measure to prevent a company obtaining a tax deduction on the write-down of a subsidiary held in the long-term fund.
The new life tax regime does not recognise the 'shareholder fund' other than under the transitional rules (FA2012/SCH17/PARA35) where assets of what was previously referred to as the shareholder fund were grandfathered into LTBFC (LAM11050). Following the introduction of Solvency II in 2016 the regulatory return no longer has any reference to assets being for other than long-term business.

Therefore, all assets of a life company, unless not held for the purpose of the life insurance business (see LAM11070), now support the life insurance trade unless they qualify for the specific LTBFC exception.

The purpose of the LTBFC legislation

Although there are still a few life companies with general insurance business, a life insurer is now only permitted to conduct life insurance business (PRA Supervisory Statement SS8/15 Solvency II: composites). For that reason, in most cases, all of a life insurance company's assets will be held for the purpose of the long-term business. The assets will be held as investments, backing the insurance liabilities, for example, to meet the insurance liabilities or contribute to the regulatory capital of the business. Assets will be held in the company's long-term insurance fund with income, gains and expenses included in the computation of trade profits unless the asset qualifies as LTBFC.

The purpose of FA2012/S137 is to ensure that any income from structural assets and any increase or decrease in the value of those assets is excluded from the computation of trade profits. This is on the basis that these assets are structural to the business rather than trading assets.

LAM11030: Long-term business fixed capital: meaning of long-term business fixed capital

Meaning of long-term business fixed capital

FA2012/S137

The legislation at FA2012/S137 provides the meaning of "long-term business fixed capital" (LTBFC) for a life insurance company.

An asset forms part of a company's LTBFC if it meets the following criteria:

- it is held for the purposes of the long-term business
- it is a structural asset.

An asset will be held for the purposes of the long-term business if it is held to support the life assurance business or other business which consists of carrying out contracts of long-term insurance. This will include permanent health insurance (PHI) business.

For guidance on "structural assets" see LAM11040.

Note that as part of the transition to the new life tax regime which commenced on 1 January 2013, assets previously treated for tax purposes as not held for the long-term

insurance business (i.e. regarded for tax purposes as in a company's 'shareholder fund' at 31 December 2012) were grandfathered into LTBFC regardless of whether or not they were structural assets (FA2012/Sch17/Para35). LAM11050 deals with grandfathered assets.

LAM11040: Long-term business fixed capital: structural assets: FA2012/S137(3)

An asset forms part of a life insurance company's long-term business fixed capital (LTBFC) if it is:

- held for the purposes of the long-term business
- a structural asset.

This section of the guide deals with the meaning of "structural asset".

The legislation at FA2012/S137(3) sets out assets which should be treated as being structural. Shares, debts and loans which, if they had been held at 31 December 2012, and would have been included in lines 21 to 24 of Form 13 of the regulatory return are regarded as structural where they are held outside a with profit fund. Lines 21 to 24 of the regulatory return of that period referred to UK insurance dependents and other insurance dependants. S137(3) simply reproduces the rule in FA1989/S83XA (now repealed). In this way the legislation makes it clear that insurance subsidiaries of the life company should be treated as structural and form part of the company's LTBFC. The inclusion of the word "includes" at FA2012/S137(3) indicates that assets other than insurance subsidiaries may also qualify as structural.

Why does the legislation specifically mention insurance dependants? There are two reasons. First it provides an example of an asset which would ordinarily be considered to be part of the fabric of the wider business of the group. Second, where shares in an insurance subsidiary are held in a non-profit fund, it would be possible to transfer the business of the subsidiary to the non-profit fund, by means of a Part VII transfer, and claim a trading loss on the reduction in the value of the shareholding. If the shareholding is structural and treated as LTBFC under FA2012/S137, it will not be possible to claim such a trading loss.

Where s137(3) FA 2012 and Paras 35/35A Sch 17 FA 2012 do not apply, a company has to form a view of whether an asset is a 'structural asset'. There is no statutory definition. The term is not used anywhere else in the Taxes Acts. But both 'structural' and 'asset' are two normal English words. Whether something is an 'asset' is unlikely to be controversial. But what does it mean to say an asset is a 'structural asset'?

HMRC and industry agreed during discussion leading to the new 2012 legislation that first principles should be used to determine whether an asset is structural. This should not be taken to mean that the term "structural" is synonymous with the distinction between capital and revenue expenditure. Whether or not assets, other than insurance dependents, qualify as structural should be determined using a full analysis of the facts in order to establish whether the asset is structural to the business or not. For example, wholly owned subsidiaries and the premises in which the trade is carried on are likely to be structural assets within an insurance business unless they are held in a with profit fund or are managed in the same way as other long-term insurance trading assets. In the case of assets held in with profit funds of proprietary companies, which are available to meet policyholder liabilities, the presumption is that they will not be structural assets because they contribute to the benefits enjoyed by the policyholders.

The nature of a life insurance company's trade involves holding assets such as shares, bonds, commercial property and infrastructure for long periods to meet future policyholder liabilities. It is common for life insurance companies to hold portfolios of equities and properties for many years, decades in some cases, in order to meet policyholder liabilities without this calling into question their status as trading assets.

A regulation making power is included in the legislation at FA2012/S137(5) to allow the Treasury to specify assets which are, or are not, to be regarded as structural assets. This power has not been used so far.

LAM11050: Long-term business fixed capital: grandfathering: FA2012/SCH17/PARA35 and FA2012/S137

Transition to the long-term business fixed capital regime

The concept of a life insurance company having long-term business fixed capital (LTBFC) was introduced with the new life tax regime from 1 January 2013. Transitional rules are held at FA2012/SCH17/PARA35 and PARA35A.

Under the previous life tax regime (to 31 December 2012), life insurance companies could hold assets outside the long-term fund. These assets were returned in Form 13 of the regulatory return as other than long-term insurance business assets. The new life tax regime from 1 January 2013 takes no account of a "shareholder fund" as the tax is based on the financial statements, not the regulatory return. In addition, under Solvency II, the previous distinction between the long-term fund and shareholder fund has disappeared and companies generally show all their assets as available to back long-term insurance liabilities.

As part of the transition to the new life tax regime (from 1 January 2013), paragraph 35 regards assets held in the shareholder fund at 31 December 2012 as assets forming part of the LTBFC of the company. This is regardless of whether or not they would otherwise qualify as LTBFC under the new rules in FA2012/S137.

However there is an exception to this grandfathering provision. If the investment return arising from such assets was reflected in the I-E computation or the trade profits for any period of account ending prior to 1 January 2013, the underlying asset will not be treated as part of the LTBFC.

Replacement of grandfathered assets

If a grandfathered asset is sold and the proceeds used to acquire a new asset, it will be necessary to consider FA2012/S137 to determine, on a factual basis, whether or not the new asset qualifies as LTBFC. If necessary, a full analysis of the facts will be required to establish whether or not the new asset is a structural asset.

Where a replacement asset does not qualify as LTBFC it should be regarded as a trading asset held for the purposes of the long-term business. This is unless the facts show that the asset is held for a general insurance business or, exceptionally, another purpose which clearly sets it outside the long-term insurance business.

LAM11060: Long-term business fixed capital: tax treatment: FA2012/S137 and FA2012/S122

Different tax treatment for LTBFC assets

Where an asset forms part of the company's long-term business fixed capital (LTBFC) (LAM11030), the ordinary tax rules applicable to an investment company apply instead of the life insurance tax rules. The table below highlights the key differences in tax treatment between LTBFC, I-E and the trading computations. The difference in tax treatment for all reliefs and losses is explained in the loss matrix at LAM15100.

LTBFC	BLAGAB I-E	BLAGAB trade profit	Non-BLAGAB trade profit
• Dividends not taxable • Equity holding, taxed on a realisation basis but Substantial Shareholding Exemption (SSE) applies where holding is 10% or more • Equity holdings, mark to market movements are not taxable • Loan Relationship holdings, mark to market movements taxable • Elections under ss171-171C TCGA can apply to LTBFC – see LAM03220 for full details.	• Dividends not taxable • Equity holding, taxed on a realisation basis rather than mark to market. SSE exempts gains and losses where holding is 30% or more • Loan Relationship holdings, mark to market movements taxable	• Dividends included • Equity holdings, mark to market movements are taxable • Loan Relationship holdings, mark to market movements taxable	• Dividends taxable • Equity holdings, mark to market movements are taxable • Loan Relationship holdings, mark to market movements taxable

Take the example of a life insurance company with a 60% shareholding in another insurance company. If the asset was held as LTBFC there would be no tax payable on dividends received. Also, any gain on disposal would be exempt under the SSE and there would be no recognition of any increase in value of the shares over the period held. The asset would effectively be free of tax. Contrast this with a 5% holding in the same asset which would be treated as a trading asset. In that case the dividends received along with the movement in the value of the shares would be included in the computation of trade profits.
Given the significant difference in tax treatment depending on whether the asset is held as LTBFC or as a trading asset, it is important from a practical point of view that HMRC are aware of and agree on which assets are treated as LTBFC.

The mechanics of the tax legislation

One of the conditions for an asset to qualify as LTBFC is that it must be held for the purposes of the long-term business. Therefore the allocation rules in Chapters 4 and 6 of FA 2012 still strictly apply to these assets in the same way they apply to other assets. However in practice allocations of investment return and profits will not be made for assets within LTBFC because they will be ignored in the I-E computation and the trade profit computations.

The exclusion of LTBFC assets from the I-E and trading computations is achieved by the following provisions:

- FA 2012/S74(6) provides that in calculating BLAGAB income, no account is taken of income arising from an asset forming part of LTBFC
- FA 2012/S75(3) makes similar provision for BLAGAB chargeable gains and BLAGAB allowable losses
- FA 2012/S113 provides that receipts or expenses [for example, loan relationship debits] which arise from an asset forming part of LTBFC are left out of account in calculating BLAGAB and non-BLAGAB trade profits
- FA2012/S122 provides that assets forming part of LTBFC that form or contribute to the s119(1)(e) or s120(1)(e) FA 2012 share pool assets (both the 1982 and s104 TCGA pools) are to be treated as not being held for the purpose of long-term business for the purpose of s212 TCGA (deemed disposal gains and losses)

The effect of the above provisions is that investment return and profits from LTBFC assets are excluded from the BLAGAB and non-BLAGAB computations.

Transfers of long-term business

The general rules concerning transfers of long-term business are dealt with at LAM13010. FA2012/SCH17/PARA35A specifically deals with the LTBFC assets on a transfer of long-term business.

Where a company (A) transfers all of its basic life assurance and general annuity business and non-BLAGAB business to another company (B), and the transfer is a relevant intra-group transfer, the assets form part of the LTBFC of company B instead of company A.

LAM11070: Assets and liabilities not part of the life insurance business

A life insurance company can hold assets and liabilities which are not for the purpose of the life insurance trade. Whether such assets and liabilities are held is a question of fact but HMRC expect those circumstances to be very limited.
An example arises where a life insurance company also writes some general insurance business and the associated assets and liabilities will not be held for the purposes of the long-term business.

In general all of the assets of a life company will support the solvency of the long-term business. Therefore HMRC do not expect that any assets held by a life insurance company, including portfolio investments, will fall outside the life or general insurance businesses altogether.

LAM12000: International and cross border

LAM12010 Other international issues – overview

LAM12020 Overseas life insurance companies FA2012/S139(1)

LAM12030 Branch exemption CTA2009/S18Q

LAM12040 Overseas Life Assurance Business – OLAB FA2012/S61

LAM12100 Controlled Foreign Companies Overview TIOPA 2010/S371BG/BH

LAM12110 Offshore funds and BLAGAB: interaction of I-E and CFC rules TIOPA 2010/S371BH and SI 2012/3044/Reg 5

LAM12120 Definition of control and offshore funds held by life insurers: alignment with accounting standards: SI 2012/3044 Reg 3

LAM12130 Equity funds: An exclusion for offshore funds mainly holding equities SI 2012/3044 Reg 4

LAM12140 CFC Avoidance of double charge: modification to TCGA1992/S212 capital gains computation SI 2012/3044 Regs 2 and 6

LAM12150 CFC Provisions in practice

LAM12200 Transfer pricing

LAM12300 Diverted Profits Tax

LAM12010: Other international issues – overview

There are a number of areas where the special I-E regime and/or the nature of life insurance requires some adaptations to be made to the general rules governing the application of cross border activity.

This chapter covers the specific adaptations and relevant issues for life insurance companies and cross refers to the basic rules that apply to all companies. It also highlights some risk areas to consider in the context of the normal CT rules.

LAM12020: Overseas life insurance companies FA2012/S139(1)

An overseas life insurance company (OLIC) with a permanent establishment (PE) in the UK is subject to corporation tax on the profits arising from the PE in the same way as other companies - CTA2009/S5

There are a small number of special provisions in the legislation as well as specific OECD guidance on attribution of profits to an insurance PE. The latter are explained in more detail in the General insurance manual.

This section sets out the life insurance specific provisions and considerations for non-resident insurance companies with a UK PE.

1. FA2012/S139(1) defines an OLIC as a non-UK resident insurance company carrying out insurance business through a PE in the UK. An 'insurance company' (FA2012/S65) may be a UK company or a PE of a non-UK company and either UK or EEA/EU regulated. The I-E provisions would then apply to any BLAGAB written by the PE.

2. A significant example of this is the capital gains tax provisions. FA2012/S117 applies the capital gains tax 'boxes' rules to transfers of 'UK assets'. UK assets are those attributed to the UK PE under the provisions of CTA2009. The 'boxes' provisions apply in a similar way to that for UK life insurance companies under FA2012/S116 – LAM03210. FA2012/S120 similarly applies the share pooling rules in FA2012/S119 – LAM03230 to 'UK securities' attributed to overseas life insurance companies.

3. The attribution of assets to the UK PE must be in accordance with Part IV of the OECD Report on the Attribution of Profits to Permanent Establishments. The important role of capital and regulation for insurance companies means that reference to the company's regulatory returns may be required as these will set out the regulatory capital requirements to support the business being written. Attribution of capital is referred to in LAM12200 and in more detail in the General Insurance Manual and OECD guidance.

4. S96 makes provision to restrict the BLAGAB management expenses where an OLIC's BLAGAB in the UK includes exempt FOTRA profits. (see LAM04040)

5. S144 provides a power to make regulations to modify the provisions of FA2012 or other relevant provisions as applied to OLICs. No such regulations have been laid as at November 2018.

6. SI2006/3271 The Overseas Life Insurance Companies Regulations 2006 were not repealed when FA2012 was introduced. Some of the provisions are obsolete. Other provisions may apply by virtue of the general transitional provision in FA2012/Sch17 para 36. Some provisions that may be relevant include e.g. those relating to transfers of insurance business such as the definition in regulation 6(4) of 'insurance business transfer scheme' and 6(5) of 'qualifying overseas transfer' used in CTA2009/S337 and S636 and in CAA2001/S560

There are therefore only a few specific rules relating to OLICs with the normal rules for UK PEs applying with adjustments to take account of the different circumstances of an overseas life insurance company.

LAM12030: Branch exemption CTA2009/S18Q

UK companies trading outside the UK through a permanent establishment can elect for exemption from tax on branch profits under the provisions in CTA2009/Chapter 3A.

These provisions apply equally to life companies subject to the modification in CTA2009/S18Q. This provision effectively excludes any BLAGAB profits or losses from the profit/loss attributed to the branch for the purposes of the exemption. Profits arising from BLAGAB are not to be regarded as forming part of a 'relevant profits amount' or 'relevant losses amount' as defined in CTA2009/S18A(6).

The exemption is intended to apply to trade profits of branches whereas the BLAGAB I-E aims to tax policyholder return. It is unlikely that any BLAGAB business would be written in an overseas branch. Overseas branch business is normally written with local non-UK policyholders and will qualify as overseas life assurance business 'OLAB' and non-BLAGAB LAM12040. However, it is possible for such business to be written. The exclusion from the exemption ensures that where policies do not qualify for OLAB/non-BLAGAB treatment, the policyholder return is fully taxed in the company together with any shareholder profits in respect of BLAGAB.

LAM12040: Overseas Life Assurance Business – OLAB FA2012/S61

Overseas Life Assurance Business (OLAB) is a category of non-BLAGAB life assurance business. It is business written with non UK resident policyholders which is not 'excluded business' and which meets certain conditions. Reinsurance of OLAB is not OLAB. OLAB is non-BLAGAB under FA2012/S57(2)(f) and is therefore taxed on a trading basis.

This treatment enables UK companies to write life assurance business for non-UK residents without incurring an I-E charge, where the OLAB conditions are met.

Excluded business in FA2012/S61(3) takes out of OLAB, categories of business written with non-UK residents to the extent that these already fall within the defined non-BLAGAB categories in FA2012/S57 such as pension business, child trust fund business, individual savings account business etc. OLAB rules therefore only need to be applied where none of these other categories are relevant. In certain circumstances, where a non UK cedant reinsures life assurance business where the benefits are linked to UK land, the reinsurer will be taxed on the business as BLAGAB LAM10210.

There are regulatory powers in FA2012/S61(4-8) in particular to prescribe the requirements to demonstrate that business is OLAB. These are set out in The Insurance Companies (Overseas Life Assurance Business) (Excluded Business) Regulations 2000 and subsequent amendments, the latest being The Insurance Companies (Overseas Life Assurance Business) (Excluded Business) (Amendment) Regulations 2007. There are detailed rules governing trusts, companies and types of policies. However, the basic requirement is that the policyholder is non-UK resident, with more complex rules for trusts and where there are multiple policyholders.

Because OLAB treatment is available for what would otherwise be BLAGAB business on the basis of, broadly, policyholder residence, companies are required to maintain appropriate records, for example of policyholder residence, to demonstrate compliance with the OLAB regulations.

LAM12100: Controlled Foreign Companies Overview TIOPA 2010/S371BG/BH

SI 2012/3044: The Insurance Companies and CFCs (Avoidance of Double Charge) Regulations 2012

Insurance companies writing long-term business are subject to the normal CFC provisions in TIOPA2010/Part9A with specific provisions for companies writing BLAGAB in TIOPA2010/371BH supplemented by the regulations in SI 2012/3044. These regulations aim to ensure the practical application of the CFC rules to BLAGAB avoiding unnecessary complexity and minimising the likelihood of a double charge to tax.

The basic CFC rules in the legislation are explained in the international tax manual. This section aims to summarise the main considerations for life companies and explain the provisions in the regulations which are not specifically covered in the International manual.

Life insurers non-BLAGAB business will not be subject to a CFC charge on investments in shares on the basis that for non-BLAGAB (and BLAGAB trade profit computations) increases in value and dividends received will all be included in the computation of trading profit - TIOPA2010/371BG.

However, there may be a CFC charge, for example on LTBFC, on a life insurer under the more general provisions and in particular TIOPA2010/Part9A/Chapter 6. This is explained further in the International Manual (see INTM207000).

The particular issue for life companies writing BLAGAB arises because life insurers will often have significant holdings in offshore investment vehicles which will bring them within the relevant interest rules in TIOPA 2010/Part9A/Chapter 15 (INTM227200). The life company may, for example, have been the primary initial investor in an in-house investment fund set up by its associated investment management company. The fund would then subsequently be marketed to external investors. In addition, life companies will often hold many hundreds of offshore fund investments which themselves may have complex substructures. Property holdings are often in this category with non-UK properties held in individual overseas entities within an overall structure. The compliance burden of reviewing all of these individually for CFC purposes would be disproportionate to the tax risk.

In most cases, the return is held for the policyholder and the I-E regime already ensures appropriate taxation in the UK. The CFC regime aims to tax profits accruing

to shareholders and therefore adjustments have been made to take this into account and ease the compliance burden.

The CFC legislation and regulations cover explicitly the following situations for insurance companies subject to tax on the I-E basis:

1. Offshore funds: Exclusion from the CFC charge for appropriate I-E investments which would otherwise trigger a CFC charge – TIOPA 2010/S371BH and SI 2012/3044/Reg5 (LAM12110)
2. Definition of control: modification for certain offshore fund holdings to align it with accounting standards – SI 2012/3044/Reg3 (LAM12120)
3. Equity funds: An exclusion for certain offshore funds mainly holding equities – SI 2012/3044/Reg4 (LAM12130)
4. Double charge: modification to TCGA1992/S212 capital gains computation to adjust the market value to take account of any amounts already taxed under the CFC charging provisions – SI 2012/3044/Regs2 and 6 (LAM12140)

Items 2 and 3 are simplification measures, recognising the scale and complexity of investment vehicles held by life companies and the extent of compliance costs from a strict application of the rules. In practice, items 1- 3 means that most life company investments will not be subject to a CFC charge. However, where those circumstances do arise, item 4 provides relief from a double charge to tax.

Holdings in bonds or bond funds are generally treated as loan relationships and subject to tax on income and increases in value both in BLAGAB and non-BLAGAB calculations. Accordingly they would not be within the scope of the CFC charge: TIOPA 2010/371BG (7) and INTM194750 .

There are also CFC provisions relating to fund managers that may be relevant to investment management operations within life insurance group. These are explained in the International manual INTM194650

LAM12110: Offshore funds and BLAGAB: interaction of I-E and CFC rules TIOPA 2010/S371BH and SI 2012/3044/Reg 5

Where a life insurance company holds an interest in an offshore fund that is also a CFC, the profits within the fund are potentially subject to double taxation. Firstly, it will be subject to tax under the I-E rules, for example, on chargeable gains arising from the annual deemed disposal calculation at TCGA1992/S212 and secondly, to a potential CFC charge under TIOPA 2010/Part 9A. The Regulations seek to ensure no double charge to tax arises broadly where tax is already dealt with by inclusion in FA2012/S73.

Example:

The following simplified example illustrates how the profits might be taxed in a company writing a mixture of 40% BLAGAB and 60% non-BLAGAB business:

An offshore fund holding

- increases in value in the period by £400 and
- Pays a dividend of £100

The CFC position would be as follows:

	BLAGAB	Non-BLAGAB
Increase in Value	£160 allocated to BLAGAB	£240 allocated non-BLAGAB
CT treatment	TCGA1992/S212 and FA2012/S73 Step 2 'mark to market' increase in value £160 spread over 7 years TCGA1992/S213	£240 taxed as trading income
CFC treatment	SI 2012/3044/Reg 5 £160 excluded from CFC charge as increase in value included in FA2012/S73 Step 2	Excluded as increase taxed as trading income - TIOPA 2010/S371BG
Dividend	£40 allocated	£60 allocated non-BLAGAB
CT treatment	Dividend exempt in I-E regime	£60 taxed as trading income
CFC treatment	CFC exclusion under TIOPA 2010/S371BH Condition F as dividend would not be included in FA2012/S73 step 1	Excluded as dividend taxed as trading income - TIOPA 2010/S371BG

Non-BLAGAB is effectively excluded under the normal CFC charging provisions on the basis that the conditions in TIOPA 2010/S371BG would be met. The assets are shares held as trading assets with increases in value and dividends included in the trading computation as income. The full conditions are explained in INTM194750

The I-E share of the return may not be taken into account as income in all cases, with chargeable gains provisions applying. The provisions in TIOPA 2010/S371BH cover the treatment of BLAGAB, and removes any CFC charge where income and increases in value are already included in the I-E or where dividends would qualify for exemption. Where this is not the case, there will be a CFC charge on BLAGAB profits. The international tax manual INTM194800 sets out in full the underlying conditions and explains how to calculate a charge should this arise.

Where assets are not held solely to back BLAGAB, S371BH(10) sets out how to determine the 'apportioned profit'. The BLAGAB component is determined in accordance with the apportionment rules in FA2012/Part2/Chapter5.

In practice, most offshore funds and other investments would meet the requirements for exclusion from the CFC charge. However, there can be situations where that is not the case. For example, property funds may not have increases in value included in the I-E as these may not be within TCGA/S212. However, the CFC legislation will exclude these from charge if the insurer includes the increase in value in the I-E computation under Step 2 FA2012/S73. (TIOPA 2010/S371BH (6) as amended by SI 2012/3044 Reg 5.) In practice, this will be the case if the amount is included in step 2 regardless of whether or not it is clear that the amount would technically be included in step 1 or step 2.

Life insurers may also have assets held as Long-term Fixed Capital which would be potentially within the scope of the CFC rules as not falling under either I-E exclusions or held as trading assets. These would be subject to the normal CFC rules.

LAM12120: Definition of control and offshore funds held by life insurers: alignment with accounting standards: SI 2012/3044 Reg 3

The CFC rules will only apply where life insurance companies have direct or indirect control (as defined by TIOPA 2010/ Part 9A/Chapter 18) over an entity including an offshore fund.

However, in tiered corporate structures the ownership interests in funds can be diverse. The multiple holdings can also make it difficult to obtain evidence and documentation to establish whether the life insurance company controls the CFC. Given the range and volume of investments held by life companies, the CFC control provisions are modified to ease the compliance burden.

In order to ensure that the rules apply appropriately to all relevant parts of the fund structure, the concepts of a ‘principal CFC’ and an ‘associated CFC’ are introduced in SI2012/3044 Reg 2. This ensures that the regulations continue to apply when the Principal CFC is not subject to a CFC charge, but a CFC charge could arise from one of its subsidiary funds

This modification stipulates that control of the principal or associated CFC will be determined by reference to TIOPA2010/371RE. the CFC is a subsidiary of the UK life insurance company – ‘the parent’. in accordance with the accounting standard FRS2 (now FRS102 effective for accounting periods beginning on or after 1 January 2015). This applies regardless of whether that standard (or any revisions or updates to that standard) is adopted for the statutory accounts of the life insurance company. This means that where the life insurer holds less than a 50% interest in the offshore fund then the CFC rules will not apply to that fund.

It is therefore only likely to be fund investments that are consolidated into the statutory accounts of the life insurance company that will be controlled for the purposes of the CFC rules.

Further exclusions apply in relation to equity funds explained at LAM12130.

LAM12130: Equity funds: An exclusion for offshore funds mainly holding equities SI 2012/3044 Reg 4

Life companies will hold investments in multiple funds that hold mainly equities, many with sub structures at different levels. The compliance effort of ensuring the CFC tests were met for all the sub-holdings related to BLAGAB business could be extensive. The return on these investments is generally for the benefit of policyholders and any CFC charge would only relate to any return accruing to shareholders. Given the minimal risk of tax loss, the CFC rules do not apply where, for the principal CFC or any associated CFC:

- at least 95% of the total assets of the CFC consists of shares, and
- no more than 5% of the sum of the CFC’s assumed taxable total profits (as defined in (TIOPA2010/S37SB(1))and exempt distribution income consists of interest or a return which is economically equivalent to interest.

This regulation reduces the compliance burden of reviewing individual equity funds that meet the accounting control test, where the return would in any case be within the

scope of the I-E charge to tax and accrue to policyholders. The 5% non-equity holding condition is set at the same level as that for 'incidental non-trading finance profit' within the main CFC rules. This allows for small amounts of interest that might accrue on temporary holding of cash.

SI2012/3044/Reg 4(2) dis-applies this easement if there are arrangements in place with a main purpose to secure a tax advantage.

LAM12140: CFC Avoidance of double charge: modification to TCGA1992/S212 capital gains computation SI 2012/3044 Regs 2 and 6

Although life insurance companies will have extensive holdings in offshore funds, potentially within the CFC charging provisions, in most cases these are not likely to incur a CFC charge. This is due to the basic operation of the rules – excluding bond funds, items within the non-BLAGAB computation and operation of various easement rules.

However, there may be some exceptions. SI2012/3044/Reg 2 and Reg 6 aim to prevent double taxation if this does arise.

Relevant profits of the CFC could also be reflected in the value of the investment deemed to be disposed of by virtue of by TCGA1992/S212. In order to prevent a double charge the Regulations allow the market value used for the calculation under TCGA1992/S212 to be reduced by the amount of the CFC profits.

Where the insurance company has received a distribution from a relevant CFC in the deemed disposal accounting period the reduction may have to be adjusted depending on the profits distributed. Therefore the Regulations allow a just and reasonable adjustment to be made to the market value.

The reduction for the CFC relevant profits is made on a cumulative basis.

Example

The initial investment in the fund is £100m, with closing value of £110m at end of Year 1 and £125m at end of year 2. The taxable (separately calculated) CFC profits are £2m in year 1 and £3m in year 2. The total increase in value of £25m is taxed in year 1 as to £2m CFC charge and £8m spread over 7 years under TCGA1992/S212 and £3m in year 2 CFC charge and £12m under S212.

	Year 1	Year 2	Total
Opening value	100	110	100
Closing value	110	125	125
Increase in value	10	15	**25**
Taxable CFC profits (assumed)	2	3	5
Taxable under TCGA1992/S212	8	12	20
Total taxed			**25**

The overall amount taxable amount over the two years of £25m, subject to the spreading rules, is made up of £5m CFC charge and £20m S212 taxable amount. The example deals with the typical case where the result of the S212 calculation is a gain – but it could equally well be a loss. The approach above will work equally well where

losses are involved. However, where distributions are made the calculations become complex.

Distributions may be made out of earlier years and/or in year distributable profits. This means the potential for double counting can vary widely. In order to minimise the need for detailed rules to cover every situation, regulation 6(3) allows for a “just and reasonable” adjustment to be made to the market value of the assets within S212 to eliminate any potential double taxation.

LAM12150: CFC Provisions in practice

In order to ensure that the CFC rules have been complied with, life insurers will need to have a process to ensure the portfolio is reviewed for compliance.

In practice, this means that for companies writing BLAGAB:

18. equity funds which meet the control provisions in SI 2012/3044 Reg 3 need to be tested to evidence that they meet the tests in Reg 4 - LAM12130

19. bond funds are identified and excluded where the conditions in TIOPA 2010/S371BG (7) are met

20. other funds which are CFCs need to be reviewed to identify any where the return is not excluded by the provisions of TIOPA2010/S371BH

The ability to include the investment return in FA2012/S73 step 2 means that in practice, an actual CFC charge is less likely to arise, with all the complications of the potential double taxation.

LAM12200: Transfer pricing

The provisions of TIOPA 2010/Part 4 apply as normal to life insurance companies. Transfer pricing aims to ensure that the profit arising in the UK is commensurate with the value added from UK activity when taking account of functions performed, assets used and risk assumed. Intragroup transactions should be priced on an arms-length basis which would be agreed between independent parties.

There are particular considerations to take into account for life companies in UK to UK transactions:

- **Intragroup recharges at cost:** Where regulatory constraints mean that a mark-up on cost cannot be added between, for example a with-profit fund and a service company in the same group
- **Differential tax rates**: Where income and expenses may be subject to different effective tax rates. This could be due to part of the expense being deductible in the FA2012/S68 I-E computation as a management expense at 20% with income taxed at the normal CT rate of say, 17%.

The other specific area of transfer pricing risk relates to intragroup reinsurance. Reinsurance is a normal feature of the insurance market and is used as a capital management tool by the industry. The impact of reinsurance intragroup can often be to shift a share of the profits offshore and therefore it is an important area to review.

Further information on reinsurance is included in chapter 10.

Intragroup recharges at cost

Insurance companies regulated in the UK have restrictions placed on their activities by the PRA and the FCA (or EEA equivalents). The PRA Rule book, conditions governing business 9 states that (for Solvency II firms) an insurance firm
'……….must not carry on any commercial business other than insurance business'

This results in insurance groups (for example if they are covered by Solvency II) often being required to set up separate entities to carry out, for example, shared service activity which includes services to other group members. The insurance company would risk breaching the rule above if it was carrying out a service business alongside insurance activities.

In addition, many life insurance companies have 'With-profit' funds where charges into the fund are subject to regulatory scrutiny, to ensure that policyholders are not being overcharged by shareholder companies.

Historically, many life companies charge for services into their life funds on the basis of cost, without any mark up for profit. Although this is not necessarily accepted as arm's length in other circumstances, it has been accepted in many cases as the basis for charging into life companies. This is because the charging basis has been agreed with the regulator or been subject to some regulatory scrutiny or constraint and would normally be a charge into a with-profit or similar fund where the policyholder interests are predominant.

If there are concerns that the transfer pricing may not be appropriate, understanding the regulatory position is likely to be a good starting point. Note that varying regulatory rules may apply for example to smaller insurers, Friendly societies and mutuals.

Where a service company provides services group-wide, consideration may need to be given as to how the benefit of scale (often provided by the life company) should be taken into account in other recharges.

Differential rates of tax

Generally, a UK – UK transaction may be regarded as low risk where there is a limited risk of tax loss to the UK exchequer where both entities are within the UK CT net. This does not, however, relieve taxpayers from the obligation to self-assess on an arm's length basis in accordance with TIOPA 2010/Part 4.

However, as BLAGAB profits in the I-E calculation may be subject to tax at the policyholder rate, charges into the life company may be deducted at a different rate to the income in the service provider. Historically, policyholder and CT rates have varied with CT rates being higher than policyholder rates until financial year 2014. In FY 2017, CT rates at 19% fell below the policyholder rate which is linked to the basic rate of income tax of 20%.

The regulatory constraints on charges to the UK life company make any transfer pricing manipulation less likely and this tax rate differential should only be considered if there are reasons for concern.

LAM12300: Diverted Profits Tax

There are no special diverted profits tax provisions for life insurance companies.

There are a number of insurance examples provided in the Diverted Profits Guidance which could be relevant

- Insurance groups with intragroup reinsurance DPT1390 example 1.
- Insurance groups providing offshore bonds DPT1390 example 3.

Reference should be made to the DPT guidance on these points.

The life insurance offshore bond is the only example which is specific to life insurance. The example sets out one scenario where DPT does not apply. However, DPT can potentially apply in these cases and each case must be assessed on its own facts.

Further information on intragroup reinsurance for life companies is included in LAM10000

LAM13000: Transfer of long-term business

LAM13010 Transfers of long-term business: Introduction

LAM13020 Transfers of long-term business: Commercial background

LAM13030 Transfers of long-term business: Summary of the process for Part VII of FSMA 2000 transfers

LAM13040 Transfers of long-term business: The taxation of insurance business transfer schemes: FA2012/S128-135

LAM13050 Transfers of long-term business: Accounting for business transfers

LAM13060 Transfers of long-term business: Intra-group transfers: FA2012/S129

LAM13070 Transfers of long-term business: Transfers between non-group companies: FA2012/S130

LAM13080 Transfers of long-term business: The anti-avoidance rule: FA2012/S132

LAM13090 Transfers of long-term business: Friendly societies: FA201/S152

LAM13100 Transfers of long-term business: Other tax consequences of business transfers: expenses: corporation tax liabilities

LAM13200 Transfers of long-term business: Accounting for Part VII Transfers: UK GAAP and IFRS Diagrams

LAM13010: Transfers of long-term business: Introduction

What are Part VII transfers of business?

Where an entire life insurance business, or part of a business, is bought or sold there is often a need to transfer the policies from one insurance entity to another. Financial Services and Markets Act 2000/Part VII provides a statutory mechanism allowing insurers (and reinsurers) to transfer portfolios of insurance business from one insurer to another, at a fixed time and date, after obtaining court approval.

There are broadly three circumstances in which a Part VII transfer is used:

- to combine the businesses of two or more subsidiaries
- to transfer businesses between third parties
- to separate out books of business by transferring them to separate companies

The alternative to employing Part VII is to novate individual policies. Novation is an agreement between the policyholder and each insurer whereby the insurance contract with the transferring insurer is replaced by a fresh contract with the successor. However most portfolios comprise far too many policies for novation to be practical. Instead, under Part VII, the transfer is effected by way of court order and policyholder rights are protected by the court process. The court has wide discretion to transfer property and liabilities to the transferee. But unlike reinsurance, where the contracted liability remains with the original insurer, the contractual relationship passes to the transferee following a Part VII scheme.

Part VII transfers can occur between third party regulated insurance companies or they can take place between regulated insurance companies within the same group. Transfers may also be cross border; there are EEA equivalent mechanisms for cross border transfers.

LAM13020: Transfers of long-term business: Commercial background

There are many commercial reasons for insurers wanting to enter into a Part VII transfer of business.

Economic efficiencies

Within an insurance group lower costs can be achieved by bringing together different books of insurance that may have been written in different subsidiaries or held in subsidiaries that have recently been acquired.

Bringing different books of insurance together may achieve capital efficiencies where uncorrelated risks are pooled. This has become more important since the introduction of the Solvency II regulatory regime. Consolidation can also reduce the costs of administering each policy by scaling up and those may include regulatory costs. The transfer may also enable the group to rationalise its structure and remove an unwanted subsidiary.

Rationalisation of the business

It may also be commercially desirable for an insurance group to separate out its legacy insurance business, particularly if it has a closed book that it either wants to manage by consolidating it with other closed books within the group, or by way of sale.

Sale or purchase

A Part VII transfer makes purchases and sales between third party insurance groups much easier, as it removes the requirement for the whole insurance company to be acquired or for complex mergers to be undertaken. Instead a much more targeted approach can be followed with only the desired part of the business being transferred.

As the application to the court can be lengthy Part VII transfers intra-group or between third parties are often preceded by an immediate reinsurance of the business from the transferor which ensures that the transferee experiences the economic consequences immediately.

LAM13030: Transfers of long-term business: Summary of the process for FSMA 2000/Part VII of transfers

Transfers of insurance business essentially transfer the contract that has been agreed between the insurer and the policyholder to another insurer without the need to obtain the policyholder's consent (see LAM13010).

Therefore any transfer of insurance business is required to follow a carefully defined process, designed to protect the policyholders' interests and to make sure that these are not damaged in any way by the transfer.

To ensure this happens FSMA 2000/Part VII requires that all insurance business transfer schemes must obtain Court approval before they can take place. The key requirements are that a report must be prepared by an Independent Expert, all policyholders must be notified of the scheme and the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) are consulted from the outset. The report will include a description of the scheme, so reading it is often the best starting point to understand what the scheme is doing.

The duties of the regulators include:

- being notified of the scheme and involved in discussions from the outset
- leading discussions with any overseas regulatory body that may be involved
- approving the appointment of an Independent Expert to report to the Court
- having the right to make written representations and to be heard before the Court

Further details of the process can be found in SUP 18.2 Insurance business transfers within the FCA handbook.

LAM13040: Transfers of long-term business: The taxation of insurance business transfer schemes: FA2012/S128-135 and FA2012/SCH17

Introduction

FA2012/Part 2/Chapter 10 covers transfers of long-term insurance business. The rules apply to transfers taking place on or after 1st January 2013.

Most schemes to which the provisions apply are those in FSMA2000/S105. This includes transfers of insurance business that result in the insurance business being carried on in an EEA state (including the UK) of:

- business carried on in the EEA by a UK authorised person
- reinsurance business carried on in a UK establishment by an EEA firm
- business carried on in the UK by an authorised person, not a UK authorised person or EEA firm, who has permission to undertake the business

Section 105 excludes 5 specific cases of transfers of insurance business from FSMA/Part VII. However FA2012/S139(1) (Minor definitions) provides a separate and much wider definition of "insurance business transfer scheme" for tax purposes, extending the definition to include the excluded schemes described in cases 2 to 5 of FSMA/Section 105(3) as well as all non-EEA branch transfers. Thus while the schemes to which the provisions will apply include all Part VII schemes, the scope is wider than that. In practice most schemes will be Part VII schemes.

FA2012/S152(2) provides that FA2012/Part 2/Chapter 10 applies to Friendly Societies. These are discussed separately at (LAM13090).

Continuity of treatment for the transferor's BLAGAB management expenses and capital gains losses is provided by FA2012/S128 and TCGA1992/S211. Where the transferor has excess BLAGAB expenses, and a balance of spread acquisition expenses, relief is given to the transferee on the same basis that the transferor would have enjoyed.

Assets within the chargeable gains rules are subject to a no gain/no loss disposal on a transfer of business of the transferor's long-term business to a transferee (TCGA1992/S139 and S211). However this is subject to TCGA1992/S212 which provides for the annual deemed disposal at market value of certain fund investments and the spreading of the resulting gains and losses. The balance of the spread gains and losses pass to the transferee and are recognised as if no transfer of business had occurred (TCGA1992/S213(5)) (see LAM03300).

Section 211ZA also allows the carry forward of unused capital losses to the transferee. The remainder of FA2012/Part 2/Chapter 10 is concerned with the calculation of both BLAGAB and non-BLAGAB trade profits and also introduces a revised anti-avoidance rule (see LAM13080).

Under the FA2012 corporation tax provisions for long-term business, trade profits or losses are calculated by reference to a company's statutory accounts. The starting point for calculating trade profits or losses arising on a transfer of business is therefore also the statutory accounts. A different taxation treatment is applied to intra-group transfers compared with transfers between third parties although each approach applies equally to both BLAGAB and non-BLAGAB business (FA2012/S129 and 130).

(Although expressed in terms of BLAGAB FA2012/S131 provides that the rules also apply to non-BLAGAB business.) (see LAM13050)

The transitional provisions in FA2012/SCH17/PARA13-14 contain some specific rules which apply to transfers of business which occur within the 10 year spreading period for deemed receipts and expenses. Where the whole business is transferred to another member of a 90% group, which is chargeable to corporation tax, FA2012/SCH17/PARA13 provides that any transitional deemed receipts or expenses are treated as arising to the transferee over the remainder of the 10 year period in the same way as they would have applied to the transferor.

Where only part of the business is transferred within a 90% group paragraph 13(4) applies so that a proportion of the transitional deemed receipts or expenses is attributed to the transferee. That proportion is determined by the amount of receipts or expenses which can be fairly attributed to the business transferred at the time of the transfer.

The transitional provisions in FA2012/SCH17/PARA14 address transfers between third party insurers and crystallise any remaining transitional amount. In that case the unexhausted transitional amount which is attributable to the whole, or part, of the transferred business is treated as arising to the transferor in the accounting period in which the transfer occurs.

LAM13050: Transfers of long-term business: Accounting for business transfers

Accounting for Part VII transfers can give rise to a wide range of different outcomes depending upon several factors:

- whether IFRS or UK GAAP (FRSs 102 and 103) accounting is adopted, which is something that can differ between transferor and transferee
- whether the transaction is a business combination
- whether the transaction is between companies under common control

Generally speaking, unless there is a full reinsurance before the Part VII transfer, the transferor will recognise a profit or loss in their income statement based on the difference between the carrying values of the transferred assets and liabilities in their accounts at the time of the transfer, and the consideration received, if any. However in the case of the transferee there is a wider range of accounting possibilities – particularly for transactions between group companies.

For all business transfers one of the key issues is whether the transferee ought to recognise an asset representing the Present Value of In–Force business “PVIF” and, separately, goodwill. PVIF and goodwill together represent the excess of the price the transferee has paid for the business acquired over the fair value of the assets acquired, although the reverse scenario, giving rise to negative goodwill, is also theoretically possible under UK GAAP. Under IFRS negative goodwill cannot arise and the credit would be recognised as income in the income statement. An illustration of the variations in accounting treatments of Part VII transfers under UK GAAP and IFRS depending on the facts is included in LAM13200.

LAM13060: Transfers of long-term business: Intra-group transfers and demutualisations: FA2012/S129

Transferee ‘stands in the shoes’ of the transferor for tax

Where the transferor and transferee are members of the same group when the transfer occurs and the transferee is within the charge to corporation tax in relation to the transfer, FA2012/S129 ignores any trade profits or losses arising from the transfer and disengages the transfer pricing rules so that the transferee effectively “stands in the shoes” of the transferor. That outcome is achieved by disregarding any amounts relating to the transfer which are credited or debited in the accounts, of either party, which ensures that an intra-group transfer gives rise to neither a profit nor loss. This approach also applies to demutualisation but not to transfers into or out of a with-profits fund unless the transfer is with another with-profit fund. The expectation is that transactions between shareholders and with-profit funds will occur at fair value.

Differences in valuation between transferee and transferor

However it is possible that the parties to the transaction might place different values on some of the assets or liabilities of the transferred business. If that valuation difference were disregarded it could result in an amount of profit either being taxed twice or falling out of account altogether. The rules in FA2012/S129(6) to (8) ensure that outcome is avoided. Any valuation differences on items that would normally be brought into a life company trade profit computation are treated as a trading receipt or expense arising to the transferee in the accounting period in which the business is transferred.

The starting point for the calculation in Section129(8) is the “net amount” recognised by the transferor and transferee. That amount is represented by:

- the transferred assets less
- liabilities relating to the insurance contracts at the point immediately before (transferor) or immediately after (transferee) the transfer

The relevant liabilities and assets are the liabilities and assets of the insurance business transferred whose values impact upon the trading profit. An amendment to Section129(8) clarified this position for transfers on or after 31 December 2015, making it clear that only those liabilities and assets which give rise to profits or losses within the trade calculation rules are compared.

As the net amount involves subtracting the liabilities from the assets it is capable of being a negative amount where the transferred liabilities exceed the assets.
The operation of these rules means that:

- any amounts relating to either assets and liabilities in respect of a transfer debited or credited in the accounts in consequence of the transfer will be disregarded by FA2012/S129(4) or (5)
- both assets and liabilities relating to the insurance contracts will be taken into account, in Section129(6), for the purposes of calculating any difference in the values recognised by the transferor and transferee

Where a mutual insurer transfers its whole business to a third party it is possible that the rules in FA2012/S129 and S130 both apply as the transaction is treated as a demutualisation and the business is transferred to a non-group company. In those

circumstances the acquiring company might recognise PVIF on its balance sheet. However PVIF, unless recognised within a with-profit fund, is not an asset which gives rise to an amount which is recognised by s129(8) and therefore it will not be taken into account in arriving at the ‘net amount recognised’. It follows that no amount will be taken into account under S129 and also S130.

The net value of the assets less the liabilities of each of the transferor and transferee are compared to arrive at an arithmetical difference which will be recognised as either a receipt or expense of the transferee. This difference is an absolute amount and is only capable of having a positive value (i.e. it cannot be negative) regardless of which amount is larger. This is the case because the difference is derived from a comparison rather than a subtraction of one value from another.

In accordance with FA2012/S129(6) & (7) if the result of adding that difference to the transferor’s net amount is that it is equal to the transferee’s net amount then it is treated as a receipt of the transferee. If, on the other hand, that parity is only achievable by subtracting the difference from the transferor’s net amount then the difference is an expense of the transferee. This can be illustrated by two examples:

Example 1		**Transferor £’m**	**Transferee £’m**
Assets		1,000	1,100
Liabilities		(950)	(975)
“Net amount”		50	125
(i) (6)(a) transferee	125		
(ii) (6)(b) transferor	50		
(iii) Difference	75		
Parity requires adding (iii) to (ii) 7(a) applies to tax a receipt of £75m on the transferee.			

Example 2		**Transferor £’m**	**Transferee £’m**
Assets		1,000	975
Liabilities		(950)	(1,100)
“Net amount”		50	(125)
(i) (6)(a) transferee	(125)		
(ii) (6)(b) transferor	50		
(iii) Difference	175		
Parity requires subtracting (iii) from (ii) 7(b) applies to recognise an expense of £175m in the transferee.			

LAM13070: Transfers of long-term business: Transfers between non-group companies: FA2012/S130

In the case of transfers between non-group companies, or with-profit fund transfers, the accounting profit or loss arising to the parties is calculated according to the normal rules, by following the statutory accounts. The assumption is that such transfers will occur at fair value. There is an exception to this general approach in FA2012/S130.

Where, as a consequence of a Part VII scheme, a transferee creates an asset in respect of the present value of in-force business ‘PVIF’ then debits and credits arising in respect of that asset are taken into account in calculating the company’s trade

profits. In effect the company will obtain relief for the amortisation of any PVIF acquired as a result of a Part VII transfer at arm's length. However no account will be taken of debits and credits arising from internally generated PVIF or PVIF acquired before 1st January 2013.

FA2012/S130 specifically denies relief where the asset is one to which the intangible asset regime in CTA2009/Part 8 applies. However PVIF will not qualify for intangibles relief as CTA2009/S806(3)(ca) confirms that Part 8 does not apply to assets so far as they are derived from, or are referable to, contracts or policies of insurance.

LAM13080: Transfers of long-term business: the anti-avoidance rule: FA2012/S132

The anti-avoidance rule in FA2012/S132 applies where a company secures a corporation tax advantage which arises from profits charged to tax under either I-E or CTA2009/S35 (trade profits). The provisions apply to "insurance business transfer arrangements" which refers to the transfer scheme and any arrangements connected to that scheme entered into on or after 1st January 2013. The concept of arrangements is wide and can be expected to include associated reinsurances and any other transactions undertaken in connection with the business transfer.

The provisions in Section132 apply where the main purpose, or one of the main purposes, of entering into business transfer arrangements is a purpose which consists of securing a tax advantage to any company. The remedy in Section132(4) is to make adjustments to income and gains sufficient to negate the tax advantage, apportioned on a just and reasonable basis where necessary.

A company may make an application in writing under FA2012/S133 for clearance from HMRC that:

- None of the company's main purposes in entering into the arrangements is an unallowable purpose, or
- in the case of an intra-group transfer, that the transfer produces no overall tax advantage for the group

A clearance application under FA2012/S133 must be made in writing and contain details of the insurance business transfer arrangements. HMRC may, within 30 days of receipt of the application, request further particulars to allow a decision to be made. Either the decision or the request for further particulars must be made within 30 days of receipt of the application. Where further particulars are provided HMRC has 30 days from receipt to provide a decision. If the applicant fails to provide the further information requested within 30 days, or such longer period that HMRC gives, then the application may not proceed further.

If any particulars provided under this section do not fully and accurately disclose all facts and considerations material for HMRC's decision, any resulting notice under FA2012/S133 is void.

LAM13090: Transfers of long-term business: Friendly societies: FA2012/S152

FA2012/S152 ensures that the transfer of business rules in Chapter 10 apply to friendly societies in the same way as to other life assurance companies. That includes transfers of business to and from a friendly society, amalgamations of friendly societies and

conversions of a friendly society into a company which is not a friendly society. Where the transferred business is conducted on a mutual basis the trading profit rules in Chapter 10 will have limited applicability.

Where exempt BLAGAB or eligible PHI business of a friendly society is included in a business transfer arrangement from a friendly society to an insurance company or on conversion of a friendly society to a company that business continues to be exempt from corporation tax on the profits arising from it and that business is treated as a separate business from any other business carried on by the company (FA2012/S158). However if the contracts included in the arrangement are varied subsequent to the transfer, increasing the premiums payable, then the exemption no longer applies for the accounting period in which the contracts were varied and any subsequent accounting period.

If an insurance business transfer scheme transfers long-term business from an insurance company to a friendly society, any BLAGAB or eligible PHI business relating to the contracts transferred is not capable of being exempt BLAGAB or PHI of the friendly society (FA2012/S157).

LAM13100: Transfers of long-term business: Other tax consequences of business transfers: expenses: corporation tax liabilities

Many expenses incurred in connection with the acquisition or sale of a business are likely to be capital expenditure. Some of the costs incurred in connection with the transfer of an insurance business under Part VII of the Financial Services and Markets Act 2000 may also be capital in nature. Further guidance can be found at BIM35525.

FSMA 2000/Part VII provides a statutory scheme for the transfer of assets and liabilities of an insurance business and it is possible for all of the property of the transferor to be transferred in this way. Each scheme is unique and the court has extensive supplementary powers to facilitate the transfer. It is common for the rights and liabilities of the transferor firm to become the rights and liabilities of the transferee to a greater or lesser degree. That can include tax assets and liabilities in the same way as other types of property. In some circumstances the Scheme can even require the dissolution of the transferor immediately following the business transfer although that would be unusual in the case of a Life company.

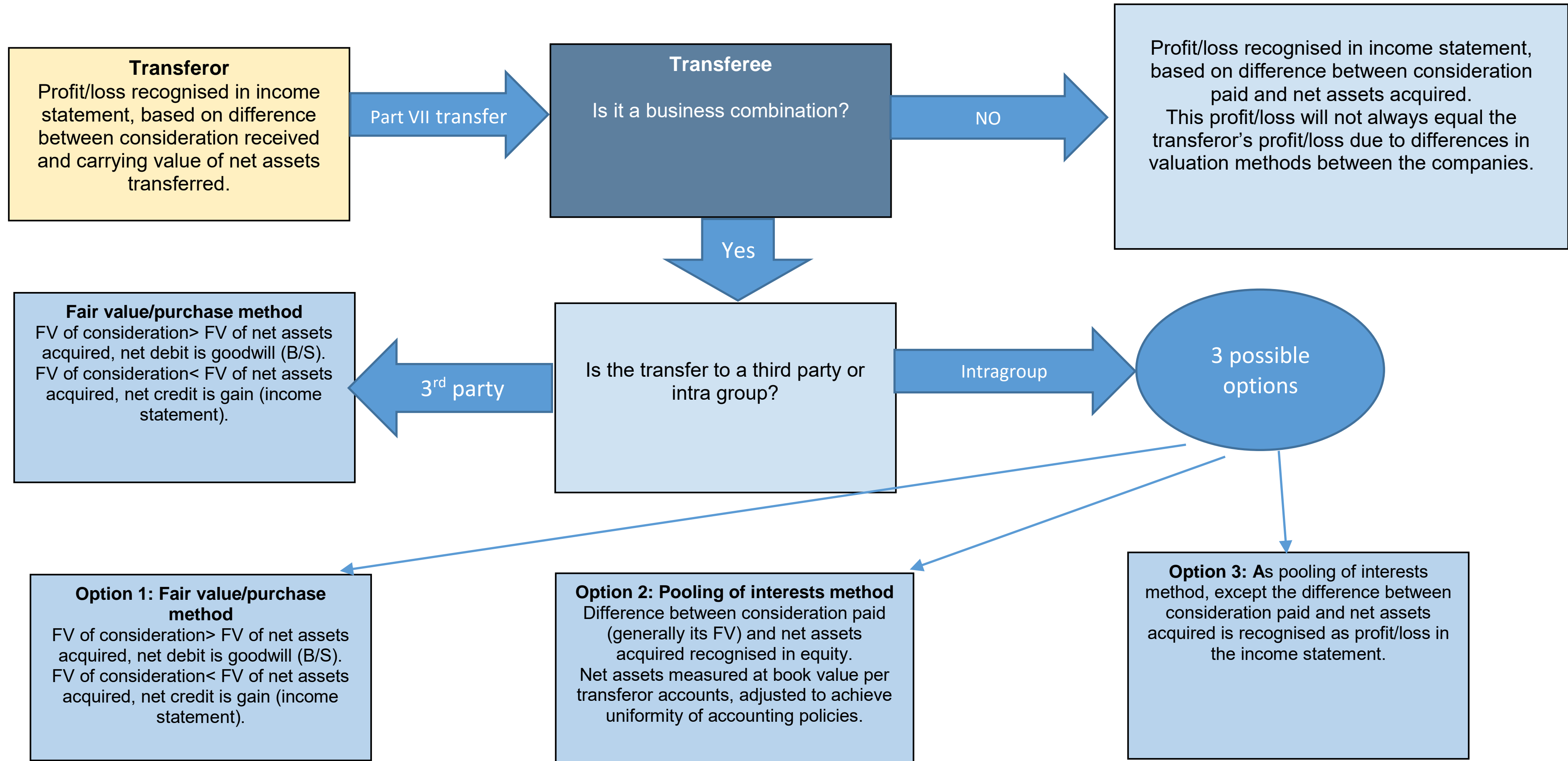
Problems can sometimes arise when the transferor is wound up or dissolved and it has outstanding corporation tax repayments or amounts due because, after dissolution, a company no longer has any legal personality or capacity to act. It is possible for the right to recover CT, or a liability to pay CT, to transfer to the transferee company if that is the effect of the Court Order and the asset or liability exists at the time of the transfer. However the right to submit and amend returns (including the making of claims) cannot be transferred because the procedural tax machinery is unaffected by the Part VII procedure. This distinction arises because the ability to file a tax return is a matter of legal capacity rather than property.

VAT and Stamp Duty issues can also arise in the context of Part VII transfers. In the case of VAT any questions should be raised directly with the group’s CCM. In the case of Stamp Duty the relevant specialist should be contacted.

LAM13200: Transfers of long-term business: Accounting for Part VII transfers: UK GAAP and IFRS Diagrams

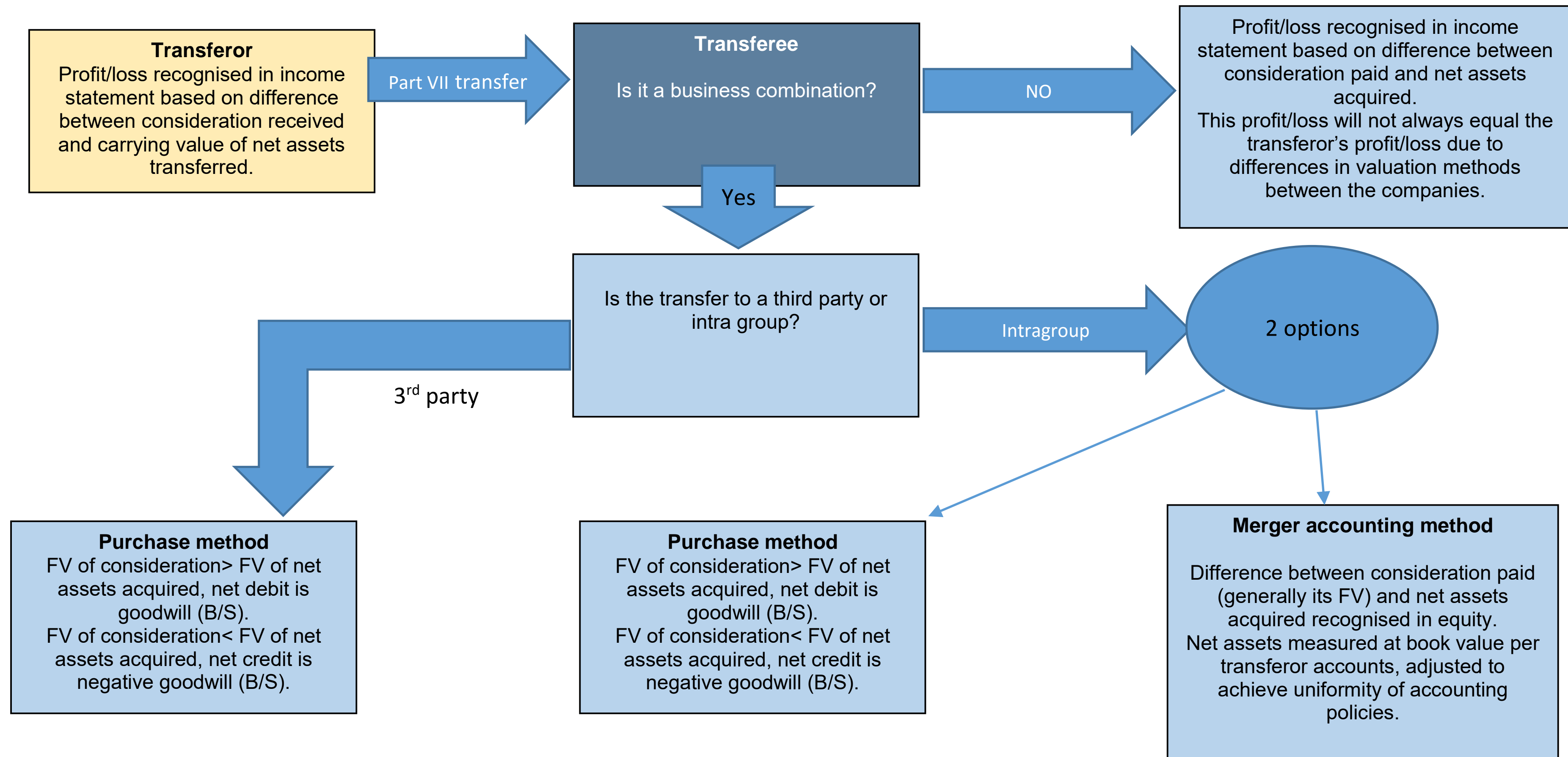
The diagrams in LAM13210 and 13220 illustrate some of the questions that arise in considering how to account for a transfer of business under IFRS and UK GAAP, with an indication of the appropriate accounting treatment depending on the facts of the particular situation. This is provided for background information as referred to in LAM13050.

LAM13210: Accounting for Part VII Transfers - IFRS



'Net assets acquired' includes any PVIF. Goodwill is over and above any PVIF recognised by the transferee

LAM13220: Accounting for Part VII Transfers – UKGAAP



'Net assets acquired' includes any PVIF. Goodwill is over and above any PVIF recognised by the transferee

LAM14000: Finance Act 2012 and Transitional Provisions

LAM14010 Transitional provisions overview and scope of this chapter: FA2012/SCH17

LAM14020 Overview of the transitional adjustments

LAM14030 The total transitional difference: Deemed receipts or expenses: FA2012/SCH17/PART1

LAM14040 BLAGAB consisting wholly of protection business: FA2012/SCH17/PART2/PARA21

LAM14050 Disregard of amounts previously taken into account: Deferred acquisition costs (DAC) and deferred income reserve (DIR): FA2012/SCH17/PART2/PARA22

LAM14060 Intangible fixed assets: FA2012/SCH17/PART2/PARA24

LAM14070 Assets held for purposes of long-term business: FA2012/SCH17/PARA25-28

LAM14080 Carry forward trade profits, excess management expenses and BLAGAB trade losses: FA2012/SCH17/PART2/PARA29

LAM14090 Assets held other than for the purposes of long-term business: FA2012/SCH17/PART2/PARA35

LAM14010: Transitional provisions: overview and scope of this chapter: FA2012/SCH17

FA 2012 introduced a new tax regime for life insurance companies. This chapter gives an overview of the provisions dealing with the transition from the old tax regime to the new regime which commenced on 1 January 2013. The chapter focuses on the ongoing impact of the transitional rules and their impact on corporation tax returns post the 2013 transitional year.

The key change under the 2013 regime was the adoption of life company statutory accounts as the basis for the computation of taxable trade profits. Under the old regime, the taxation of life companies (and in particular the computation of trade profits) was based on returns made by companies to the industry regulator. The transitional provisions operated to quantify the transitional adjustments required to ensure that all profits were taxed once but once only, on the change of basis.

The transitional provisions are contained in FA2012/SCH17 and The Insurance Companies (Transitional Provisions) Regulations 2012. These provisions apply in parallel with a supporting Statutory Instrument: SI 2012/3009 as amended by SI 2013/2244 - The Insurance Companies (Amendment to FA2012/SCH17 (Transitional Provision)) Regulations 2013.

A simplification measure was also included in the transitional provisions relating to the change to the treatment of protection business which from 1 January 2013 is now within non-BLAGAB. Policies written prior to 1 January 2013 continue to be treated as BLAGAB unless the insurer made an irrevocable election for that business to be treated as non-BLAGAB (LAM14040).

LAM14020: Transitional provisions: overview of the transitional adjustments: FA2012/SCH17

The basis of calculation for the transitional adjustments were agreed as part of the transitional year 2013 tax returns. Specific guidance on the basis for these adjustments was published by HMRC. There should be no further requirement to review these calculations and therefore this chapter does not cover the detail of how to calculate the initial adjustments.

The main provisions set out in FA2012/SCH17 are as follows:

Provision	Description
Deemed receipts and expenses FA2012/SCH17/PARA1-20	Comparison of ‘the 2012 balance sheet’ per the financial statements with the ‘2012 periodical return’ and specifies how the differences should be treated on transition LAM14030
Election for ‘old’ BLAGAB protection business FA2012/SCH17/PARA21	Election to treat ‘old’ BLAGAB protection business as non-BLAGAB under the new rules - a simplification measure for companies only writing protection business LAM14040
Amounts previously taken into account (DAC) FA2012/SCH17/PARA22	Provisions to ensure that amounts previously taken into account for tax, principally deferred acquisition costs and deferred income reserves, are only taxed or deducted once LAM14050
Intangible fixed assets FA2012/SCH17/PARA24	Transition required as I-E companies previously excluded from intangible assets provisions of CTA2009/ business LAM14060

Assets held for purposes of long-term business FA2012/SCH17/PARA25-28	Rules to facilitate the allocation of chargeable assets between BLAGAB and non-BLAGAB and the adjustment of separate pools base costs LAM14070
Carry forward of trade profits and management expenses FA2012/SCH17/PARA29-34	Provisions dealing with unused losses at 31 December 2012 which could be carried forward and used against profits in the new regime LAM14080
Assets of the Shareholder Fund FA2012/SCH17/PARA35	With the disappearance of the concept of the Shareholder Fund for tax purposes rules to govern the grandfathering of existing assets LAM14090

In addition there is a general transition provision in para 36 which ensures that existing legislation continues to apply with any necessary modifications, as appropriate.

There are special provisions relating to transitional adjustments on transfers of business which are explained at LAM13050.

LAM14030-80 summarise the main provisions and explain the expected impact on corporation tax returns once the initial adjustments had been made in 2013, i.e. from 2014 onwards.

LAM14030: Transitional provisions: The total transitional difference: Deemed receipts or expenses: FA2012/SCH17/PART1

Up until 31 December 2012, surplus in the regulatory returns provided the base for taxation of life insurance company profits.

From 1 January 2013 taxation is based on the profit in the financial statements in line with other companies. Transitional provisions were required to ensure that all profits were taxed once but once only, on the change of basis.

In the majority of cases there was untaxed profit as at 31 December 2012, which had been recognised as profit in the financial statements but not recognised as surplus in the regulatory return. In a few cases, there will be amounts that need to be removed from the financial statements taxable profit in future years as they have already been taxed as regulatory return surplus.

FA2012/SCH17/PART1 sets out the rules for calculating 'deemed receipts or expenses' which are the untaxed or unrelieved amounts to be brought into account for corporation tax purposes. These are explained briefly below and in full in the original guidance.
The approach is to compare 'the 2012 balance sheet' at 31 December 2012 with 'the 2012 periodical return' i.e. compare the balance sheet in the financial statements and the regulatory return, with provision for deemed balance sheets and returns to be put in place if these are drawn up for a different accounting period.

FA2012/Sch17/PARA6 refers to the results of that comparison as the 'total transitional difference' (TTD). The TTD is then analysed and broken down into component parts, i.e. deemed receipts and expenses. Each component is either an 'excluded item' (FA2012/sch17/Para7) or a 'relevant computational item' (RCI).

The RCIs are allocated between BLAGAB, non-BLAGAB and PHI. RCIs for PHI are ignored but for BLAGAB and non-BLAGAB the resulting amounts are treated as taxable receipts or expenses in the relevant trade profits computation arising evenly each year over a ten year period from 1 January 2013, with certain exceptions. FA2012/SCH17/PARA11-15.

The exceptions to the spreading period above relate to 'relevant court protected items' where there is a court order preventing distribution of surplus. The date for spreading commencing in these cases is the later of the day the court order ceases to be in place or 1 January 2015.

In most cases the last year of deemed receipts or expenses will be 2022. A simplified example of the comparison is set out below:

Description **Asset/(liability)**	**FSA return** **£**	**Balance Sheet** **£**	**Difference Rec/(Exp)** **£**
Mathematical reserves/technical provisions	(50)	(60)	(10)
With Profit Fund Form14.51/ FFA or UDS	(300)	(220)	80
Other	20	0	(20)
Total Transitional Difference			50
Allocation to BLAGAB and NON-BLAGAB	**BLAGAB** **£**	**Non-BLAGAB** **£**	**Total** **£**
Allocated according to rules in Sch 17	10	40	50
Spread over 10 years – annual amounted taxable	1	4	5

There are specific provisions which can result in the spreading being brought to an end and all the remaining amounts being brought into account. This can happen if a business is transferred under an insurance business transfer scheme – and more detail is given at LAM13040. If a business ceases, other than through an insurance business transfer scheme, then any remaining deemed receipts or expenses are brought into account in the period of cessation (FA2012/SCH17/PARA15).

The calculation of the total transitional difference often required detailed discussion to deal with varying circumstances between insurers. The detail of the calculations is therefore of dwindling historical interest.

LAM14040: Transitional provisions: BLAGAB consisting wholly of protection business: FA2012/SCH17/PART2/PARA21

Background

The pre FA2012 regime treated protection business as BLAGAB. As a result, tax was based on investment income plus gains less expenses rather than on trading profit.

However, protection business is not a savings product, so applying the ‘I-E’ concept of taxing the policyholder investment return was not consistent with the objective of the regime. This treatment could create significant distortions in the tax charge. The expenses relating to these products were fully deductible in the I-E computation although the offsetting premium income was not. Some of these protection products, such as mortgage protection and payment protection products paid high commissions to intermediaries and generated significant tax deductions for expenses but relatively small amounts of investment income.
At the same time as the introduction of the new life tax regime, the treatment of protection business was changed from BLAGAB to non BLAGAB. This aligns it more closely with the taxation of other wholly risk based insurance products, such as general insurance policies, taxable on a normal trading basis.

Protection business is defined in FA2012/S62 and is intended to include pure life insurance which pays out on death or incapacity. There are a number of conditions to the definition but the main element relates to contracts where:

> “the benefits payable cannot exceed the amount of premiums paid except on death, or in respect of incapacity due to injury, sickness or other infirmity, and the contract is made on or after 1 January 2013”

In assessing the benefits test, the following are to be ignored:

- non-cash inducements (such as small gifts) to enter into the contract;
- excesses which are an insignificant proportion (although there is no guidance as to the threshold of insignificance); and
- amounts only payable in highly unlikely circumstances

The new regime introduced in FA2012 treats protection business written from 1 January 2013 as non-BLAGAB business.

Transitional provisions

The transitional provisions in FA2012/SCH17/PARA21 provide for an irrevocable election to treat ‘old’ BLAGAB protection business as non BLAGAB under the new rules. This election can be made

- where the insurance company only writes protection business and
- the election is made on or before the filing date for the first accounting period where the new regime applies (for most insurers with December year ends, by 31 December 2014)

This is a simplification measure. A company with ‘old’ protection business and expenses still to deduct will never obtain any effective tax relief if there is no savings business with ‘I’ to offset the ‘E’. Accordingly, there is no benefit in maintaining two sets of computations for ‘old’ and ‘new’ business.

This election therefore will already have been made if it is relevant and it is too late for any further elections to be made. Computations for companies that were in existence prior to 1 January 2013 and only writing protection business should have one combined non BLAGAB computation if they have made the relevant election. Where such an election is made, paragraph 21(3) ensures that no relief will be available for excess BLAGAB management expenses carried forward into the 2013 regime. Other companies with protection business pre and post 1 January 2013 who have not elected will have to separate the income and expenses for protection business before and after this date as part of the tax computation.

LAM14050: Transitional provisions: Disregard of amounts previously taken into account: deferred acquisition costs (DAC) and deferred income reserve (DIR): FA2012/SCH17/PART2/PARA22

If an amount has been taken into account for tax purposes before 1 January 2013, it is not to be included in any future trade profit calculations. Similarly, if an amount has been brought into account as an I-E expense before 1 January 2013 it is not to be included in any BLAGAB I-E calculation after 1 January 2013

In practice, DAC and DIR are the most obvious accounting items which potentially either fall out of account or are taxed twice but there are likely to be others. Paragraph 22 applies whenever there is a mismatch between the pre and post-2013 rules so that amounts fall out of taxation or are recognised more than once.

Life insurance companies incur costs to acquire business but do not necessarily write these off immediately in the accounts. Acquisition costs are generally spread over an appropriate period of years, depending on the nature of the policies to which they relate. As a result, there will be an amount of deferred acquisition costs (DAC) held on the balance sheet as an asset which have not yet been deducted in the profit and loss account. Similarly, there will be an amount of deferred income reserve (DIR) representing premium income relating to a future accounting period which has not yet been recognised in the profit and loss account. More information on accounting for acquisition costs is in LAM07040

However, in the regulatory return, acquisition costs and premium income were written off in full. In comparing the balance sheets, the regulatory balance sheet will have zero DAC and DIR but the financial statements balance sheet will have what is often a sizeable DAC asset and also some DIR.

In comparing the balance sheets as at 31 December 2012, the provision at FA2012/SCH17/PARA7(2)(a) treats DAC as an excluded item. DIR was treated as an excluded item under FA2012/SCH17/PARA7(2)(e) and Regulation 4 (Category 7) of the supplementary regulations at SI 2012/3009.

This means that the DAC and DIR on the balance sheet at 31 December 2012 are ignored for the purposes of calculating deemed receipts or expenses under those provisions.
Therefore, as no opening adjustment has been made to take into account the earlier tax treatment of DAC and DIR, the transitional provisions require adjustments in the tax computation for the DAC and DIR held at 31 December 2012 as they are released to the profit and loss account in the financial statements.

In practice, methods will have been agreed for identifying the amount of DAC and DIR in the profit and loss account that relate to periods prior to 1 January 2013. These will have to take account of the company’s accounting policies as well as the method for allocating income and expenses between categories of business.

For computations from 2014 onwards, it will be necessary to understand what has been agreed, and on what basis, and obtain any necessary comfort that the agreed approach has been followed.

LAM14060: Transitional provisions: Intangible fixed assets: FA2012/SCH17/PART2/PARA24

Under the pre FA2012 regime the legislation relating to intangible fixed assets at CTA2009/PART8 did not apply to assets held for the long-term business of an insurance company.

FA2012 amended the legislation in CTA2009/S901 to bring life insurance companies taxed on the I-E basis within the scope of the intangibles regime.
The transitional provisions at para 24 ensure that expenditure on any asset prior to 1 January 2013 is not taken into account in applying the rules in CTA2009/PART8.

The treatment in the BLAGAB and non-BLAGAB trading computations should apply using normal principles, for example, by adding back pre-2013 amortisation.

S88 FA2012 deals with the treatment of intangible asset credits and debits in the I-E computation:

- intangible asset credits and debits referable to BLAGAB are netted;
- a net credit is taxable as income (Step 1 of section 73)
- a net debit is treated as BLAGAB expenses for the period.(until accounting periods beginning after 15/9/16 net debits were only relieved in the following accounting period)

Tax deductions for intangibles do not tend to be significant items in life insurance company computations.

Where these do arise, careful attention should be paid to the application of the provisions.

LAM14070: Transitional provisions: Assets held for purposes of long-term business : FA2012/SCH17/PARA25-28

These transitional rules ensured that there were no tax consequences arising from the changes made in FA2012 to:

- the allocation of chargeable assets between BLAGAB and non BLAGAB
- the working of share pools where base costs were adjusted

These should not have any ongoing relevance to computations post 2013.

LAM14080: Transitional provisions: Carry forward trade profits, excess management expenses and BLAGAB trade losses: FA2012/SCH17/PART2/PARA29

Transitional provisions at para 29-34 set out the rules for how unused losses and excess management expenses as at 31 December 2012 are to be carried forward and used against profits in the new regime.

The amounts should all be agreed in 2013 and these provisions should have no further impact. More detail is provided in the original guidance.

LAM14090: Transitional provisions: Assets held other than those of the long-term business: FA2012/SCH17/PART2/PARA35

The term ‘shareholder fund’ was used in the past to describe assets that historically were held by a life insurance company outside the ‘ring fenced’ regulatory long-term insurance fund. These assets were returned in Form 13 of the regulatory return as assets other than those of the long-term business, notwithstanding that those assets were available to back the long-term business.

Under the current prudential regulatory regime and Solvency II, there is no concept of a separate ‘long-term insurance fund’. In the regulatory returns all the assets are held to back the long-term business of the company. The concept of a ‘shareholder fund’ of assets not within the long-term insurance fund has no tax relevance.

This part of the transitional provisions deals with how these historical ‘shareholder fund’ assets are to be treated on transition to the new regime. This is covered in more detail at LAM11060.

LAM15000: Excess expenses, losses and deficits

This chapter summarises the relevant rules applicable to the offset of losses and other reliefs against the different sources of profit in a life insurance company.

These rules are also referred to in more detail in other relevant chapters.

The table below lists the main sources of losses and reliefs and indicates in green where these may be relevant in the computations of the life company tax charge.

Profit computation Loss type	BLAGAB I-E	BLAGAB trade	Non-BLAGAB long term business trade	LTBFC* / other non-trading	General insurance
Management expenses					
Trade losses					
Capital losses					
Deemed capital losses TCGA1992/S212					
Non-trading loan relationship / derivative deficits 'NTLRD'					
NTL –intangible assets					
UK property business loss					
Capital allowances – investment assets					
Capital allowances – management assets					
Group relief claims	**S/H share**				

**LTBFC is Long Term Business Fixed Capital*

Significant changes to the loss relief rules were made with effect from 1 April 2017 by F2A2017. Where an accounting period straddles 1 April 2017, for the purpose of applying the loss relief rules it an accounting period is treated as ending on 31 March 2017, with a new one beginning on 1 April 2017.

The matrix in LAM15100 sets out a summary of the specific rules for what can be offset in each case and explains where these vary from the normal rules for offset.

Group relief

The matrix in LAM15100 explains how excess expenses, losses and deficits can be utilised within a life insurance company. Subject to specific rules on the order of set off excess expenses, losses and deficits can also be surrendered to other group companies by way of group relief, with the exception of excess expenses, or XSE, and LR deficits in the I-E computation. However, BLAGAB trade losses can be surrendered by way of group relief despite BLAGAB trade profits themselves not being subject to Corporation Tax.

Life insurance companies can also claim group relief surrendered by group companies against their total profits, subject to the exception which prohibits group relief being set off against I-E profit taxed at the policy holder rate.

LAM15100: Loss Matrix

Loss/relief	BLAGAB I - E	BLAGAB trade	Non-BLAGAB trade	Long Term Business Fixed Capital (LTBFC) and other non-trading business	Short-term business (e.g. general insurance)
Management expenses	Adjusted BLAGAB management expenses are set against I - E income and net chargeable gains of the period. Excess expenses can only be carried forward and treated as BLAGAB expenses of the next period.	X	X	Exceptionally the general rule at CTA2009/S1219 could apply to expenses from the management of grandfathered assets in LTBFC or other non-trading activity. Expenses are set against income from the non-trading business in the period. Excess expenses can be: 21. Set off against total profits of the period (excluding BLAGAB policyholder share of I-E profits)	X

Loss/relief	BLAGAB I - E	BLAGAB trade	Non-BLAGAB trade	Long Term Business Fixed Capital (LTBFC) and other non-trading business	Short-term business (e.g. general insurance)
				22. surrendered as group relief; 23. carried forward and set against LTBFC/non-trading income of the next period.	
Trade losses	X	A BLAGAB trade loss (LAM7310) of the period can be: 24. set sideways against shareholder total profits of the period (i.e. non-BLAGAB trade profit, , the shareholder share of I-E profit, profit arising in long-term business fixed capital and any general insurance profit); 25. set against shareholder total profits for the previous 12 months;	Non-BLAGAB trade losses (LAM7300) are treated as "normal" trade losses and can be: • set against shareholder total profits* of the period, then any remaining losses can be set against shareholder total profits* of the previous 12 months; • surrendered as group relief; • carried forward and set against future	X	Losses from any short-term business such as general insurance are treated as "normal" trade losses and can be: 28. set against shareholder total profits* of the period; 29. any remaining loss can be set against shareholder total profits of the previous 12 months; 30. surrendered as group relief;

Loss/relief	BLAGAB I - E	BLAGAB trade	Non-BLAGAB trade	Long Term Business Fixed Capital (LTBFC) and other non-trading business	Short-term business (e.g. general insurance)
		26. surrendered as group relief; 27. carried forward and set against any BLAGAB trade profit of the next period. A BLAGAB trade loss utilised under any of the first three options above requires two adjustments to be made: • firstly the loss must be reduced by any BLAGAB non-trading deficit – see S126 FA2012, then; • the BLAGAB management expenses of the period must be reduced (at step 4 of S76 FA2012) by the quantum of loss utilised.	non-BLAGAB profits. *Shareholder total profits include: - the shareholders' share of the I - E profit; - non-BLAGAB trade profit; - profit arising from long-term business fixed capital; - profit from any short-term business.		31. carried forward and set against future profits of the short-term trade. *Shareholder total profits include: - the shareholders' share of the I - E profit; - non-BLAGAB trade profit; - profit arising from long-term business fixed capital; - profit from any short-term business.
Capital losses	BLAGAB capital losses (LAM3200) can be utilised as follows:	X	X	Capital losses not arising from BLAGAB will be set off against any Capital gains not	

Loss/relief	BLAGAB I - E	BLAGAB trade	Non-BLAGAB trade	Long Term Business Fixed Capital (LTBFC) and other non-trading business	Short-term business (e.g. general insurance)
	• set against BLAGAB chargeable gains of the period (including deemed gains (LAM3300); • carried forward and set against BLAGAB chargeable gains of the next period; • the shareholder share of the net BLAGAB allowable loss can be set against non-BLAGAB gains (LAM3420).			arising from BLAGAB. Any excess losses can be • Set off against any shareholders share of BLAGAB gains, or • carried forward to the next period and set against chargeable gains arising not arising from BLAGAB in future periods or shareholder share of any BLAGAB gains in future periods.	X

Loss/relief	BLAGAB I - E	BLAGAB trade	Non-BLAGAB trade	Long Term Business Fixed Capital (LTBFC) and other non-trading business	Short-term business (e.g. general insurance)
Deemed capital loss under S212 TCGA (LAM3340)	A net deemed chargeable loss can be carried back (in full or in part) and set against net BLAGAB deemed gains in the previous two accounting periods. Any net deemed loss remaining is spread over 7 years. 1/7th of the net loss is treated as an allowable loss of the accounting period with a further 1/7th treated as an allowable loss at the end of each succeeding accounting period.	X	X	X	X
Non-trading loan relationship deficit (loan relationships and derivatives)	Any BLAGAB NTLR deficit (LAM3070) is to be used firstly against BLAGAB income and gains of the period. Any remaining deficit can be carried back for up to 3 accounting periods ending within the 12 months	X	X	A NTLR deficit arising in LTBFC is treated as a “normal” non-trading deficit under CTA2009/S456. The deficit can be: • set against shareholder total profits of the period;	X

Loss/relief	BLAGAB I - E	BLAGAB trade	Non-BLAGAB trade	Long Term Business Fixed Capital (LTBFC) and other non-trading business	Short-term business (e.g. general insurance)
	immediately before the deficit period. Any deficit still remaining is carried forward to the next period and treated as a deemed BLAGAB management expenses of that period.			• carried back (in full or in part) and set against any NTLR profit of the previous 12 months; • surrendered as group relief; • carried forward and set against non-trading profits for future accounting periods.	
Non-trading loan relationship deficit (Intangible assets)	Any non-trading deficit (LAM3070) arising from an intangible asset is treated as a deemed management expenses of the period.	X	X	Any non-trading deficit arising in LTBFC is treated as a "normal" non-trading deficit under CTA2009/S456. The deficit can be: • set against shareholder	X

Loss/relief	BLAGAB I - E	BLAGAB trade	Non-BLAGAB trade	Long Term Business Fixed Capital (LTBFC) and other non-trading business	Short-term business (e.g. general insurance)
				total profits of the period; • carried back (in full or in part) and set against any non-trading profit of the previous 12 months; • surrendered as group relief; • carried forward and set against non-trading profits for future accounting periods.	
UK property business loss	An overall net loss arising from BLAGAB property business (LAM3900) is treated as a deemed management expense of the period.	X	X	X	X

Loss/relief	BLAGAB I - E	BLAGAB trade	Non-BLAGAB trade	Long Term Business Fixed Capital (LTBFC) and other non-trading business	Short-term business (e.g. general insurance)
Capital Allowances – investment assets	Investment capital allowances can be deducted in the BLAGAB I - E computation. S545(3) CAA2001 denies relief for investment capital allowances in non-BLAGAB.	X	X	X	X
Capital Allowances – management assets	Management capital allowances are brought into account at step 3 of S76 FA2012.	Management capital allowances can be deducted in the BLAGAB trade computation.	Management capital allowances can be deducted in the non-BLAGAB trade computation.	S18 & S253 CAA2001 allow for capital allowances on plant & machinery used in managing the investment business.	The normal capital allowances rules apply to general insurance business. See GIM4030 and CTM02350.
Group relief offsets					
Group relief	The shareholders' share of the I-E profit can be relieved by group relief surrender by other group companies.	X	The normal group relief rules apply to a claim against a non-BLAGAB trade profit.	The normal group relief rules apply to a claim against any profits arising in LTBFC.	The normal group relief rules apply to a claim against any short-term business profit.