

TAX REP 2/04

TAX LAW REWRITE: GAINS FROM CONTRACTS FOR LIFE INSURANCE ETC

Memorandum submitted in January 2004 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to Paper CC(03)19 on Gains from contracts for life insurance etc issued in November 2003 by the Inland Revenue

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TAX LAW REWRITE: GAINS FROM CONTRACTS FOR LIFE INSURANCE ETC (PAPER CC(03)19)

A GENERAL COMMENTS

1. We welcome the opportunity to comment on the Revenue's Paper CC(03)19 published on 28 November 2003 at <http://www.inlandrevenue.gov.uk/rewrite/index.htm>
2. The structure of the clauses within Chapter 10 of Part 4 (Gains from contracts for life insurance etc) follows a logical sequence, and the incorporation now in clauses 489-498 of the Personal Portfolio Bonds (Tax) Regulations 1999/1029 so far as they apply for income tax purposes as regards personal portfolio bonds is appropriate.
3. The basic structural change of combining, wherever possible, the provisions concerning life insurance policies, contracts for life annuities and capital redemption policies, to eliminate unnecessary duplication and cross-referencing, is sensible.
4. As this is anti-avoidance legislation, we appreciate the difficulty in rewriting it without impairing its scope; but whilst the rewritten clauses accurately and more intelligibly record the purposes of the present legislation, they do not make easy reading.
5. Clauses 475-488 in particular will prove very difficult for a lay reader to understand, even with the help of the Explanatory Notes, although they are clearly a commendable effort to rewrite complex original legislation (much of which originates from the FA 2001 amendments). The relegation to Schedule 1 of certain date-related provisions of lesser relevance, in chronological order and with appropriate signposts from the relevant Chapter 10 clauses, also makes the rewritten legislation clearer.
6. Whilst the approach adopted for these clauses, as explained in Explanatory Notes paragraph 8, results in legislation of greater intelligibility, these clauses even as rewritten bring to the fore the question of whether, in a self-assessment context, as a matter of policy and outside of the tax law rewrite project, consideration should be given to the introduction of simpler provisions to counter avoidance in place of the existing legislation. The recent amendments in particular have made any ready understanding of it impossible. It can only be understood with the expenditure of considerable effort and whilst it might be argued that simplicity is impossible in such a complex financial area if avoidance is to be effectively countered, even the rewritten legislation is likely to prove beyond the comprehension of most taxpayers without expert help.
7. In the Explanatory Notes, on page 5, in the first bullet point under clauses 469-474, it might be helpful to emphasise in bold the words 'other than one arising on any part

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surrender or part assignment . . .’ to the end of the sentence; and, in the clauses 475-484 bullet point heading, to also put ‘Part surrenders and assignments’ in bold.

8. It might be further helpful in the Explanatory Notes to highlight more clearly the fundamental purpose of the rules in clauses 485-487, as exceptions to the rules in clauses 475-484 – to attribute gains to the persons actually profiting where events take place in the same insurance year as a change in the ownership of the rights – and to include a more lay reader-friendly explanation as to why clause 488 is necessary, where part surrenders and assignments occur in the final insurance year.
9. Clauses 499-511, dealing with reductions from gains, income tax treated as paid and reliefs, and the relief for deficiencies are now rewritten more intelligibly than the original legislation.
10. We have no difficulties with any of the matters raised in the Questions (please see Section B).

B RESPONSES TO QUESTIONS

***Q1:** Change 104 legislates Part 1 of ESC B53 (as it relates to individuals). We welcome comments on this proposed change.*

11. Agreed.

***Q2:** Change 110 removes the requirement to carry out the calculation under clause 482(2) for an insurance year in which there has been no assignment for money or money’s worth or surrender of a part of, or share in, the rights under the policy or contract. We welcome comments on this proposed change.*

12. Agreed.

***Q3:** Change 112 replaces the provisions in PPB(T)R in primary legislation but retains certain powers to make regulations about personal portfolio bonds. We welcome comment on this proposed change.*

13. Agreed; but clause 498(2) should be specifically restricted in its application to personal portfolio bonds (please also see comments on clause 498(2) in Section C).

***Q4:** Change 105 applies the rules in section 110 of FA 1989 to determine whether trustees are non-United Kingdom resident for the purposes of the exception to clause 500 (which provides for the reduction of gains when policy holders are not United Kingdom resident) and of paragraph 11 of Schedule 1 (which modifies the exception in that clause). We welcome comments on this proposed change.*

14. Agreed.

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Q5: *Change 114 limits the rewrite of the application of section 553A(3) of ICTA (which disapplies the benefit of section 553(7) of ICTA) to policies within paragraph (b) of the definition of a “foreign policy of life insurance” in clause 457(2). We welcome comments on this proposed change.*

15. Agreed.

Q6: *Change 83 requires a claim under this clause to be made to the Inland Revenue (as defined by clause 780), rather than to the Board of Inland Revenue. We welcome comments on this proposed change.*

16. Agreed.

Q7: *Change 83 substitutes the Inland Revenue (as defined by clause 780), rather than the Board of Inland Revenue, as the person whom an individual may require to certify the amount recoverable under this clause. We welcome comments on this proposed change.*

17. Agreed.

Q8: *Change 118 applies a definition of “market value” for the purposes of the Chapter. We welcome comments on this proposed change.*

18. Agreed.

Q9: *Change 106 legislates Part 3 of ESC B53. We welcome comments on this proposed change.*

19. Agreed. It is helpful to incorporate Part 3 of ESC B53 within Schedule 1, which will give a newly UK resident holder of a policy or contract adequate time within which to vary it in order to meet the paragraph 26 Schedule 1 second selection condition. Please also see our comments on paragraph 27(4) Schedule 1 in Section C.

C SPECIFIC COMMENTS

cl 449 Non-UK resident trustees and foreign institutions

20. The wording of the second sentence in draft Explanatory Notes paragraph 48 needs clarifying.

cl 452 Determination of shares etc

21. Does not the reference to ‘not a share in all these rights’ need to be qualified by reference to clause 450(7), in the same way that s 547A(13) ICTA is qualified by reference to s 547A(2) ICTA as regards an assignment or surrender of only a part of or share in any rights?

cl 453 Trusts created by two or more persons

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22. The term ‘then subject’ (to the trusts), meaning immediately before a chargeable event, is less precise than the term ‘immediately before the happening of the chargeable event’ in s 547A(6)(b) ICTA. To avoid lay readers’ possibly misconstruing ‘then’ as referring to the ‘originating’ date, it might be preferable to remove ‘then’ and add ‘immediately before the chargeable event in subsection (1)’ at the end of the sentence.

23. It would be helpful to include in the Explanatory Notes an example of the circumstances in which subclause 453(7) will apply. Its meaning is no clearer than that of s 547A(8) ICTA.

cl 455 Special rules: qualifying policies

24. It would be helpful to include a signpost to the definition of ‘qualifying policy’ (similarly in clause 465(1)).

cl 462 Conditions to be met by an excepted group life policy (4)(a)

25. The words ‘proportion of’ in s 539A(4)(a) ICTA are clearer than ‘the amount of’.

cl 471 The total allowable deductions for a policy or contract (1)(b)

26. In the case of an assigned capital redemption policy, does it need to be made clearer that only premiums paid under that policy since its assignment (s 545(4) ICTA) should be taken into account under Step 1? This will not be apparent from clause 471(1)(a) which refers to the total amount of premiums paid under a policy.

cl 472 Disregard of certain amounts in calculating gains under section 469 (2)(b)

27. As with ICTA Schedule 15 paragraph 20(2)(a), it would be clearer to include after ‘discharging’ the words ‘some or all of the’ (liability for a premium). Clause 514(4) of course provides for this alternative; but clause 472(2)(b) might be read as referring to a full discharge only.

cl 482 Method for making periodic calculations under section 475

28. Step 1 does not make it sufficiently clear that the value of **all** previous surrenders or assignments, of any part of or share in the rights under the policy or contract, valued as at the times of each of those previous surrenders or assignments, have to be added to the value of the rights whose partial surrender or assignment is at issue in the clause 482 calculation.

29. We question the need to go through Steps 1 to 3 in clause 482(4). If the values are historical and the value of each part of or share in the rights is determinable (under clause 483), why is it necessary to total the ‘component’ parts in Steps 1 and 2 only to deduct some of them again in Step 3? Whilst clause 482 works as drafted, could not the drafting instead be by reference only to the period since a previous calculation event?

(7),(8)

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30. Explanatory Notes paragraph 193 refers to clause 482(7) as applying to exclude retained replacement policy premiums from the NTP calculation only where these relate to pre-14 March 1984 policies. Is this intended? The effect of the newly drafted clause 482(8) upon clause 482(7) is also not clear. It would be helpful to have a commentary on this.

cl 495 Method for making annual calculations under section 489

31. Subclause 495(4) rewrites what was evidently intended by PPB(T)R reg 5(2)(part). There is some uncertainty, however. Clause 495 deals with the clause 489 requirement for annual calculations in relation to personal portfolio bonds. Explanatory Notes paragraph 260 explains that the format involved applies for all previous insurance years, whether the policy or contract was a personal portfolio bond in a previous year or not. This seems to follow from the definition of 'C' in PPB(T)R regulation 5(2A) which refers to 'R' and 'G' as respectively the value and amount mentioned in s 546(2) and (3) ICTA, the calculation of which does not require the policy or contract to be a personal portfolio bond.

32. However, the definition of 'B' in PPB(T)R regulation 5(2) clearly refers to previous years 'during which the **personal portfolio bond** (our emphasis) was in existence' as a personal portfolio bond. If, as the Explanatory Notes imply, a policy or contract can become or cease to be a personal portfolio bond during its existence, and the PPB(T)R regulation 5 focus is only on the years during which the contract or policy qualifies as a personal portfolio bond, then clause 495 will apparently not rewrite it accurately. Is a PRC in fact strictly needed to remove any ambiguity, so that clause 495 and the Explanatory Notes can stand as drafted? Although the Treasury has power to modify the regulations, it is not clear that it is appropriate to do this in the rewrite without the change to the regulations being noted as a PRC. We assume that in practice the Inland Revenue will have applied PPB(T)R regulation 5(2) in accordance with the procedure as written in clause 495.

cl 498 Power to make regulations about personal portfolio bonds

33. The Treasury's power in s 553C(6) is limited to the application of Chapter 11 Part XIII ICTA in relation to policies or contracts which are personal portfolio bonds **only**. Despite the clause heading, and the more limited scope of clause 498 (as explained in Explanatory Notes paragraph 275), the power taken in draft clause 498(2) to modify **any** provision of draft Chapter 10 or Chapter 2 of Part 13 of ICTA strictly appears too wide. The power to 'modify' in clause 498(2) should be qualified by the inclusion of 'as affects personal portfolio bonds' or other appropriate wording.

cl 499 Reduction for sums taken into account otherwise than under Chapter 10

34. With reference to Change 113, it is arguable that the 'amount' referred to in s 547(2) ICTA is intended to refer to an amount of gains referred to in s 547(1) ICTA and not (as in practice) to the amount of the receipts and credits taken into account for the purposes of calculating that gain. We agree, however, that as the intention is to avoid double taxation this is more suitably achieved by giving priority to the other charge and then calculating the Chapter 10 gain without regard to the receipt or other credit item already taken into account in calculating that priority charge. We accordingly agree clause 499 as drafted.

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cl 508 Top slicing relieved liability: two or more chargeable events

35. We would welcome clarification of the statutory authority for the weighted average approach adopted in Steps 3 and 4 (as Explanatory Notes paragraphs 330 and 331)? There clearly needs to be some effective multiple, as with Step 3 in clause 507(1), and in practice we have no objection to this approach which was adopted in clause 6.7.33(3) in ED8. Although in accordance with practice, does it need the sanction of a PRC?

Schedule 1

para 2 Pre-15th March 1974 policies and contracts: calculation of gains under section 482

36. How is the 15 March 1974 date determined from ICTA s 546(1)?
37. Explanatory Notes paragraph 366 might also helpfully refer to sub-paragraph (5), as concerns the final sentence.

para 8(3) Certain pre-18th November 1983 policies not foreign policies of life insurance

38. The original provision in paragraph 27(2) Schedule 15 ICTA refers to any change in the terms of a policy in pursuance of an option conferred by it. It would appear preferable to retain this more exact description rather than 'any exercise of rights' conferred by the policy as included in the Schedule 1 paragraph 8(3) drafting.

paras 11(1)(b), 15(1)(b) Certain pre-20th March 1985/pre-17th March 1998 policies: application of section 501(1)

39. With reference to Note 76, we agree the proposal to rewrite the transitional relieving subsections 553(5) and 553(5A) in accordance with practice as also being applicable to capital redemption policies and not, as enacted, to insurance policies only.
40. However, as correcting a perceived mistake in the original drafting of clause 553 and 553(5A), does this require a PRC?

para 21 Pre-9th April 2003 contract or policy: excepted group life policies

41. It would be helpful to explain in the Explanatory Notes why the 6 April 2005 date is used in paragraph 21(1) and (2); whereas the necessary variation of the policy, to ensure its continuity as an excepted group life policy, has to be effected by 6 April 2004 in subparagraphs 4(1) and (2) Schedule 34, FA 2003.

para 27(4) Modification of second selection condition: policyholder non-UK resident on 17th March 1998

42. With reference to the second bullet point in Explanatory Notes paragraph 435, the potential for the holder to have only a few days (if any), within which to effect a variation of the policy or contract appears harsh. In genuine change of intention situations, as a policy matter, a longer period within which to effect the necessary variation ought to be allowed, whether by concession or through appropriate amendment to the legislation.

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D DETAILED COMMENTS ON DRAFTING

cl 455 Special rules: qualifying policies

43. In Explanatory Notes paragraph 73 the references should be to subsections (3) and (4).

cl 470 The total benefit value of a policy or contract

44. In the section 472 title, the words ‘under this section’ should read ‘under section 469’.

cl 473 Modification of section 471: qualifying endowment policies held as security for company debts

(4)(d)(i)

45. Is there any reason why the reference is to a trade ‘carried out’ rather than ‘carried on’ under s 541(4B)(d)(i) ICTA?

cl 483 The value of rights partially surrendered or assigned

46. In the last paragraph of Note 81, the reference at the end of the third line to clause ‘j062819(1)’ should be to ‘483(1)’.

cl 488 Special rules where part surrenders and assignments occur in the final insurance year

47. In Explanatory Notes paragraph 225, the reference should be to ‘clause 488(2)’ and not to ‘clause 476(2)’.
48. In Explanatory Notes paragraph 228, in the second sentence, ‘is’ should be inserted after ‘This’.

cl 501 Exceptions to section 500

49. In Change 105, first paragraph third line, ‘policyholder’ should be ‘policy’.
50. In Change 105, final paragraph, in the third line ‘UK resident’ should be ‘non UK resident’ and in the fourth line ‘so resident’ should be ‘not so resident’.

cl 504 Relief for policies and contracts with European Economic Area insurers

51. In Note 83, in the penultimate line of the second paragraph, ‘take’ should be ‘tax’.

cl 511 Calculation of deficiencies

52. In the first sentence in Explanatory Notes paragraph 341, insert ‘of’ after ‘amount’.

Schedule 1

para 15(1) Certain pre-17th March 1998 policies: application of section 501(1)

53. Is there any reason why the bracketed description for section 501(1) should differ from that in paragraph 11(1)?

para 21 Pre-9th April 2003 contract or policy: excepted group life policies

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54. In Explanatory Notes paragraph 420, the reference should be to 'Schedule 34' and not to 'Schedule 24'.

Schedule 5

Part 2 Index of expressions defined in this Act or ICTA

55. The s 832(1) ICTA definition of 'authorised unit trust' refers the reader to s 468(6) ICTA. Would it be preferable to refer to s 468(6) ICTA direct in Schedule 5 Part 2?
56. The definition of 'trusts an individual created' is in 'section 446(3)' and not 'section 448(3)'.

14-36-13
TJH/PCB
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