EXPLANATORY MEMORANDUM

THE INSURANCE COMPANIES (TAXATION OF REINSURANCE BUSINESS) (AMENDMENT No. 2) REGULATIONS 2004 No.2257

1. This explanatory memorandum has been prepared by the Commissioners of Inland Revenue and is laid before the House of Commons by Command of Her Majesty.

This memorandum contains information for the Select Committee on Statutory Instruments.

2. Description

2.1 These Regulations amend the Insurance Companies (Taxation of Reinsurance Business) Regulations 1995 (SI 1995/1730: "the Principal Regulations") to remove an exemption from their operation for certain financial reinsurance contracts and to provide for cases where payment of premiums for reinsurance is made indirectly as well as directly. They also revoke the Taxation of Reinsurance Business (Amendment) Regulations 2004 (SI 2004/2189).

3. Matters of special interest to the Select Committee on Statutory Instruments

3.1 The instrument breaches the 21 day rule. This is because the Taxation of Reinsurance Business (Amendment) Regulations 2004 (SI 2004/2189) laid on 26 August 2004 and coming into force on 16 September 2004 contain errors. This instrument revokes that one, and, in order to avoid the defective provisions coming into effect, needs to come into force before it.

4. Legislative Background

4.1 These Regulations are being made under powers conferred by section 442A of the Income and Corporation Taxes Act 1988 ("ICTA"). The Regulations are subject to the negative resolution procedure.

5. Extent

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 This instrument is subject to annulment and does not amend primary legislation, so no certificate under the ECHR is required.

7. Policy background

7.1 Section 442A ICTA was enacted in 1995 to prevent avoidance of corporation tax by the use of reinsurance. Where a company carrying on life assurance business enters into a contract of reinsurance under which it reinsures the investment risk in policies which constitute basic life assurance and general annuity business, section 442A ICTA provides that an amount of income is imputed to the contract which comes within the charge to corporation tax. Without this charge, any investment return arising from the

business and which is paid to the cedant company by way of a reinsurance claim would escape tax.

7.2 The details of the calculation of the taxable amount are left to regulations. They proceed by identifying certain types of reinsurance arrangement which are not affected by section 442A ICTA , and by setting out the rules for calculation of the investment return in other cases.

7.3 Some types of reinsurance contract are in substantial financing transactions. It was thought that such contracts could not be used to create the mischief against which section 442A was directed, and in 2003 such contracts were excluded from the scope of section 442A by Taxation of Reinsurance Business (Amendment No. 2) Regulations SI 2003/2573.

7.4 Subsequently it has been discovered that such reinsurance contracts can be used, in conjunction with other arrangements, to avoid a charge under section 442A. Accordingly these regulations remove the exemption for such contracts.

7.5 It has also been discover that attempts have been made to circumvent the Principal Regulations by not paying the premiums for the reinsurance contract directly to the reinsurer. The amounts involved are several hundred million pounds by way of premium to reinsurance companies. The regulations ensure that indirect payments are caught by the Principal Regulations.

7.6 The change is neither politically nor legally important. There was no consultation, as it is not the practice to consult on anti-avoidance measures.

8. Impact

8.1 A Regulatory Impact Assessment has not been prepared for this instrument as it has no impact on business, charities or voluntary bodies.

8.2 The Regulations will have an Exchequer impact. They will prevent the avoidance of tax by the use of financial reinsurance contracts.

9. Contact

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