

Friendly Societies Consultation Group

6 September 2006
100 Parliament Street

Note of Meeting

Attendees

HMRC

Jim Craig (JC)
Colin McHardy (CMH)
Danny Berry (DB)

AFS

Graham Wilson (GW)
Paul Engers (PE)
Sue Goodliffe (SG)
Nick Morrell (NM)
Steve Jones (SJ)
Graham Seymour (GS)
Graham Henderson (GH)

Apologies Chris Russell (CR)

1. Minutes of last meeting

Two objections were raised to the proposed minutes.

SG thought that the minutes wrongly represented CR's suggested solution to the inadvertent breach of premium limits. However, JC thought that the minutes accurately reflected what was said, but that some members, including himself, had placed a wrong construction on the suggestion which had only been rectified when considering the draft prepared for discussion at agenda item 3. It was agreed to leave the minutes as they stood and consider the point raised when discussing item 3.

SJ pointed out that the minutes represented him as being in attendance when in fact he had been absent. The record will be amended.

Otherwise, the minutes were accepted as they stood.

2. Business Transfers

The submitted AFS paper on the mechanics of how to achieve the transfer of exempt business to a non friendly society while preserving the exempt nature of the business was discussed at length.

The principle behind the proposal for a new Section 460(11A) was accepted. Although the wording would inevitably change when considered by the parliamentary draftsman, the proposed wording achieved the required aim of preserving the exemption of BLAGAB business through a transfer.

Agreed minutes (28/9/06)

There was some discussion of whether or not it was necessary to amend sub section 10A to ensure clarity of purpose. CMH suggested that issuing a short statement of intent with new legislation might be a better and simpler way of achieving clarity of purpose. GS asked that the form of wording which might be used be made available to the group for consideration. CMH agreed that this could be done.

There was also some discussion around the point raised in the paper that Section 460(1) could not apply to a proprietary company, which might jeopardise the purpose of the new subsection. The HMRC view was that the proposed change referred to the business being transferred with the specific purpose of preserving its original status and if it was accepted that this was achieved then this potential problem did not exist. Again it was thought that this might also be clarified in the statement of purpose.

Action JC + CMH

Similarly, any surplus attaching to the transferred business should remain exempt and it should not give rise to a Case VI charge within the transferee. It was agreed that detailed consideration of this point would have to await the outcome of the amalgamation strand. CMH agreed to keep the Friendly Society aspects in mind through the consultation review process. [DN it occurs to me on reading this that we may need to think about any possible interaction this point might have with the mutual surplus legislation in this year's Finance Act]

Action CMH

It was agreed that there was no need to consider whether business transferred from a proprietary company to a Friendly Society where the premiums were below the exempt limits could qualify for exempt treatment where this had not been enjoyed prior to the transfer. The instances were likely to be few in number and any proposal would be resisted by HMRC.

JC noted that the proposals did not address the HMRC concern that these changes should not open up a route which could be used to export the Friendly Society exemption into mainstream insurance business. He had looked at possible amendments to achieve this end, but considered that it was enough to put down a marker with the AFS that if this situation occurred as a result of the changes then HMRC would look at ways of reversing what HMRC would see as an abuse. All of the AFS members reiterated that this position was both unlikely in commercial terms and undesirable from the AFS viewpoint.

The discussion then moved to consider the position of transferred exempt other business.

The proposal in the AFS paper mirrored the BLAGAB proposals.

Agreed minutes (28/9/06)

However, JC suggested that the same end might be achieved by taxing any PHI and general insurance business written by a Friendly Society under Case I as if all income is paid/reserved as benefits then gives the equivalent of the exemption.

After some discussion, it was agreed that JC would expand the proposal in a paper for consideration by the group.

Action JC

It was agreed that any statement of purpose should also cover the position of exempt other business.

The treatment of hybrid policies was also queried. This was a subject raised in general terms by the TCondoc, and the current discussion would have to be tied in.

Action CMH

3. Inadvertent Breaches of Premium Limits

SG expressed her doubts that the proposed Section 464(3A) achieved its purpose as any qualifying policy which changed ownership as a result of a divorce settlement would not be for money's worth.

After some exploratory discussion it was agreed that the proposed change stated that if the limits were breached by a policy which was neither issued to the member nor acquired by him for money's worth then the exempt status of the policy would not be affected. DB summarised the position as: currently a breach of the tax exempt limit is forgiven at the company level where the breach arose because the member took out a policy within another society. Under the proposal, this is extended slightly to include a breach caused by a member holding a policy from the same society, but only where it was transferred to the member other than for money or money's worth.

This would remove the problem of inadvertent breaches of the premium limits through no fault of the Society or the member.

There was some question as to whether policies could be sold. The 1992 Friendly Societies Act allows for payment of premiums only by members of the Society or persons connected to members and in any case the surrender values of exempt policies were below the level at which there was any market interest. In consequence, scope was limited.

It was recognised that there was a potential to abuse the position through gifting policies, but scope for this would also be limited by the 1992 Act and it was considered that exposure would be limited in any case.

It was unanimously agreed that the proposal would be put forward as it stood as a recommendation of the group, for Ministers to consider.

4. Simplification

Discussion of the paper refining the findings of the AFS questionnaire only served to underscore the difficulty of trying to find specific areas, or specific groups of Societies which had common areas of difficulty which we could address.

JC underscored the fact that any changes proposed by the group should concentrate on areas within the life code as it would be much more difficult to get changes accepted in other areas, such as quarterly payments or CG rules if they constituted a departure from the rules applying to all other UK Corporates.

GW made the point that although AFS members were generally keen to simplify matters, they recognised that simplification could mean increased CT liability and in that context they saw the current complexities as an acceptable necessity.

GW also made the point Societies sometimes suffered disproportionately from more general legislation. An example being the rules on unappropriated surplus which were aimed primarily at companies which might demutualise but could impact on Societies, particularly mid range Societies whose FSA returns were drawn up without particular regard to tax consequences and whose tax departments were limited in their resource.

Expanding on the limited tax resource point, SG wondered if it might be possible to give specific guidance on new legislation when it was issued. In particular, some steer as to whom it applied. JC said that although it was a prime objective to improve communications between HMRC and the Societies, the discussions had demonstrated again just how diverse the Societies were and so production of guidance which would be relevant across the sector would be difficult while the preparation of bespoke guidance for each Society was impracticable.

GW stated that from Liverpool Victoria's viewpoint he would like to see a period of stability rather than further change which was always resource intensive on both sides.

It was generally agreed that the FSA return was not an ideal basis for tax computations.

JC suggested that Schedule X, which had been resurrected in one of the other consultation strands, might form a basis of simplification. If it was applied only to the taxable business then there would only need to be one further apportionment.

CMH described it as a system which applied a Case I charge to the whole company and a disaggregated charge to tax the BLAGAB policyholders' share separately.

Thus, in a steady state situation, i.e. with no claims or premiums, the increase in reserves was equivalent to the policyholders' share. Adjusting for premiums and claims would then give the policyholders' share for the year.

GS remembered the Schedule X proposal from a previous consultation. However, his initial thought was that it would cause unacceptable volatility.

He also had access to papers on the subject from the previous discussions.

It was agreed that GS and CMH would compare available papers to ensure that all were working from the same versions and that AFS would look at the proposal for merit in the context of Friendly Societies.

Action GS + CMH

It was further agreed that unless the group could see value in pursuing the Schedule X proposal, simplification would await the general developments emanating from the other consultation strands. Once it became clear how the industry was changing as a whole, the subject of Friendly Society simplification could be looked at again.

Although this round of consultation would be brought to a formal conclusion at the end of September, this did not preclude discussions from continuing where there was value to be added from doing so.

5. Update on other Consultation Workstreams

CMH gave a brief overview of what progress was being made in each of the other strands.

5.1 Apportionment

This was the stream in which the Schedule X proposal had been re-introduced and was now being considered by the industry.

Otherwise a modified version of Option 3 was emerging as the industry's preferred option.

This strand was also considering the Crown Option question.

One major industry objection was the loss of management expenses and other reliefs when a change from I minus E to case I occurred. One option being considered was the restoration of these reliefs if the basis changed back to I Minus E at some future date.

Another possible option was to introduce notional income, balanced by an increase in excess E carried forward, to ensure that the I minus E result could never be less than the case I result.

The discussions of this strand may go beyond the end of September.

5.2 Amalgamation

This is seen as a potential quick win.

5 into 1 is emerging as the industry's preferred option, although HMRC remains attracted to the additional simplification provided by the 6 into 1 option.

The treatment of losses is still to be agreed.

5.3 Transfer of Business

This strand is also seen as a potential 'quick win'

Here the principle is agreed – that value should not escape the LTF across the transfer.

However, the mechanics of achieving this end remain to be worked out.

Another point of contention is the need, or otherwise for a TAAR.

The essence of the argument is how much simplification can be traded for uncertainty.

5.4 Losses and Structural Issues

It is agreed that Section 83(3) needs modification. How this is to be done is still under discussion.

It is possible that HMRC concerns which are currently dealt with by S83 (3) could be met as part of the solutions being discussed for transfers of business.

HMRC view remains that Capital injections should not impact on the P&L result (see LAM 6.57).

The proposal that group relief could be based on statutory accounts is not favoured by the industry.

In the discussions on structured assets, the industry wants exemption for dividends from subsidiaries.

6. AOB

No items were raised at this point.

7. Next Meeting

It was agreed that the next meeting should aim for signing off proposals for the Transfer of Business and the Inadvertent Breaches of Premium Limits changes. In this respect what we can achieve should not be sacrificed for what we might achieve.

To this end the next meeting should be around the end of September or as early in October as practicable.

GW undertook to coordinate dates for the AFS members. JC would do the same for HMRC.

Action JC + GW

The venue will be decided once the date is fixed as it depends on availability of rooms.