

Agreed minutes (1/8/06)

Notes of meeting on 14 June 2006 Amalgamation of categories of business Working Group

Location: ABI HQ at 51 Gresham Street, London EC2V 7HQ

Present: Jeremy Tyler – HMRC
Craig Norris – HMRC
Richard Cook – HMRC
John Wright – HMRC
Mike Chadwick – Friends Provident
Peter Hayes – CIS
Debbie Kwan – HSBC
Kate Webster – ABI
Carolyn Woodroffe - ABI
Matthew Taylor – E&Y
Phil Lewis – KPMG
Murray Hennell - HBOS

Introduction

1. The ABI indicated that the issues they had for discussion were those identified at the recent members' meeting, and from previous discussions with Richard Thomas. At the members meeting there had been agreement on 5 into 1 as the preferred outcome, but no consensus on how to get there. Due to likely difficulty in obtaining a consensus view the ABI had advised its members to approach HMRC directly if they felt strongly on the issue.

2. The "Givens"

2.1 From the HMRC perspective these are:

- Amalgamation of categories is a positive simplification for industry and HMRC
- Profits and losses will be pooled
- Subject only to ring fencing of existing PB losses going forward into the new regime.

2.2 **Issue 1:** The ABI questioned the need to ring fence PB losses. They believed that the ring fencing of existing PB losses going forward into the new regime was based on a perceived risk of a significant loss to the Exchequer. Whilst the data from 2002 may have indicated this, the general view was that significant PB losses have been utilised since 2002.

2.3 **Issue 2:** In addition given that the industry was very much PB driven, the ABI believed that the profits in the other non-PB categories were not likely to be that significant. If this were so, then regardless of the extent of the losses in practice the scope for actual Exchequer loss in any year would be limited.

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2.4 HMRC thought that perhaps a better understanding on these points would be achieved if the 2002 data were updated. HMRC agreed to review the position by reference to the submitted 2004 Life company tax returns.

2.5 **Issue 3:** In the ABI's view any changes arising from the consultation ought to be made under primary legislation rather than by regulations.

3. Assumptions

3.1 After a brief discussion the assumption that "amalgamation will be either 6 into 1 or 5 into 1" was agreed as a given.

4. Issues

5 into 1:

4.1 **Issue 4.** Paragraph 3.6 of the May 2006 Tcondoc (The Technical Consultative Document) makes the point that "if the OLAF were to be removed there is no reason why the calculation of OLAB should not follow the same pattern as the calculation of PB or LRB".

4.2 The ABI considered that there were good reasons for distinguishing the OLAF in the past, but now believed that the removal of the list of categories of assets within the OLAF would be a positive outcome. It was still considered important to retain the OLAF; in particular, for those non-UK branches through which OLAB is written, retention of the Branch assets within OLAF as quasi-linked assets matches the commercial reality of assets/liability matching.

4.3 **Issue 5.** The ABI were puzzled by the suggestion that reinsured PB should be reclassified as LRB, and were unclear as to the reasons for such a proposal. The ABI thought that the classification of products should be a matter for the FSA and actuaries rather than for HMRC. It was not helpful to have policies recategorised for tax purposes. This principle applies equally to all GRB categories of business.

4.4 The ABI also thought that if losses were not to be streamed and all categories were within GRB (Gross Roll-up Business), the proposal that reinsured PB ought to be reclassified as LRB seemed irrelevant.

4.5 The HMRC team agreed to reconsider this issue.

4.6 The ABI considered that a "5 into 1" scheme could be achievable for FA 2007.

6 into 1:

4.7 Whilst the ABI recognised that the Tcondoc sets out the pros and cons of including PHI in the amalgamation of categories, they consider that, at present the cons clearly outweigh the pros (even though simplification is very positive objective).

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- 4.8 **Issue 6.** For example, from the ABI perspective, an increase in tax due to the inclusion of UK dividends as assessable profits would be a big issue..
- 4.9 **Issue 7.** The loss of the current flexibility to utilise PHI losses within the group that would arise from a “6 into 1” solution, would be another big issue for ABI members.
- 4.10 **Issue 8 :** The ABI also thought that the transitional arrangements whereby the PHI calculation would change from one based on the accounts to one based on the FSA return would be complex (as does the Condoc). The ABI would need to know further details of the likely transitional proposals.
- 4.11 The UK dividend and loss flexibility issues made it very unlikely that a “6 into 1” solution would find broad support from ABI members.

Other issues

- 4.12 **Issue 9:** The ABI suggested that as GRB would be calculated on Case 1 principles, perhaps the profits ought to be assessed under Case 1 rather than Case VI? If GRB and PHI profits were both assessed under Case 1 and losses could be utilised as any other Case 1 loss, most of the objections to a “6 into 1” solution would disappear.
- 4.13 **Issue 10:** The ABI suggested that one possibility could be to give companies a one-off election (i.e. not reversible) to include PHI as part of the GRB. This would encourage companies with an insignificant PHI element (less than 1%) to opt for this, and thus simplifying their computations. Alternatively a company with a PHI below a stated proportion would automatically be required to prepare computations based on the “6 into 1” approach.
- 4.14 **Issue 11:** The ABI indicated that on some issues HMRC says it follows FSA practice, but on others the FSA refers to HMRC requirements. There does not seem to be any consistency in terms of which has priority. This comment was in respect of classifications and definitions of policies to categories of business.
- 4.15 HMRC agreed to raise this with the FSA.

5 Crown Option

- 5.1 The ABI said that the uncertainty of whether or not HMRC would exercise the Crown Option was a source of concern to many of its members. This was the reason that certainty on the Crown Option position was sought for 2005 and 2006 in respect of the Investment reserve proposals. Also the disappearance of reliefs such as BLAGAB excess expenses carried forward made the exercise of the Crown Option particularly difficult for companies.

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- 5.2 **Issue 12:** The ABI thought that the exercise of the Crown Option would be more acceptable if reliefs brought forward including those which would have accrued in the intervening periods during which the company had been assessed on a Case I basis were to be available again once a Case 1 basis for taxation ceased to operate.
- 5.3 **Issue 13:** Another option proposed by the ABI was to get rid of the Crown option entirely and have a permanent I-E basis. The I-E result would never be less than the Case 1 result. This could be achieved by bringing in a notional amount of BLAGAB income to the I-E with a corresponding increase to the excess management expenses carried forward. The implication in this second option was that normally the I-E should exceed the NC1 result. The ABI required the retention of the ability to utilise any Case 1 loss within the group under either proposed basis.
- 5.4 The ABI do not have a consensus view on the above two options, and so the order of mentioning these two options is not in an order of priority.
- 5.5 The HMRC team agreed to take away and consider the two Crown Option proposals set out in the meeting.
- 5.6 In addition the HMRC team agreed to consider which of the 4 Workstreams consideration of the Crown Option should be included.