

Agreed minutes (5/9/06)

Notes of meeting on 20 July 2006 Amalgamation of categories of business Working Group

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

Present: 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
Nigel Collard – L&G
John McCullough – Pru
Liz Punchard - ZFS

Issue 1: need to ringfence losses

Issue 2: actual extent of Exchequer exposure

- 1.1 The ABI provided a schedule of data collected from 19 of its members. It indicated PB losses of £1.46b as at 01/01/04 decreasing to £1.43b at 31/12/04 and to £1.36b at 31/12/05. The figures indicated that non-PB Case VI profits of £4.5m in 2004 and £24.5m in 2005 would be sheltered if there were no streaming of losses. The loss to the Exchequer would be expected to be 30 % of these two amounts.
- 1.2 The main conclusion is that although the PB losses brought forward may be large, the actual tax effect arising from the capacity to utilise the losses against other categories of business was small.
- 1.3 HMRC said that they had carried out a similar exercise involving the data from all significant insurance companies, totalling about 50. HMRC figures indicated PB losses in excess of £4b as at 01/01/04 and decreasing to £3.78b by 31/12/04. The loss to the Exchequer was more than the ABI's estimate for 2004 (nearly £50m per the HMRC figures). In other words HMRC agreed the broad trend suggested by the ABI figures. The main impact was in fact in just 6 or 7 companies. The ABI agreed to extend its request for information to all ABI life company members, to confirm broad consistency with HMRC's figures for 2004 and to identify whether the trend continued for 2005.
- 1.4 HMRC were not able to provide their data to the ABI for reasons of confidentiality.
- 1.5 HMRC said that the whole process involving the review of life insurance taxation was intended to be revenue neutral. As possible amendments in other areas (including other work streams) might involve a revenue gain, the fact

Agreed minutes (5/9/06)

that there would be a revenue loss if losses were not streamed when carried forward did not automatically rule out the possibility that streaming of losses would not be adopted. In other words the streaming of losses was only one component in the whole review.

Issue 6: the additional tax arising from inclusion of UK dividends in GRB 6 into 1

Issue 7: the potential loss of flexibility around PHI losses with 6:1

2.1 The “6 into 1” option created difficulties for ABI members due to the increase in tax arising from the inclusion of FII in PHI, and the reduction in flexibility of utilising PHI losses. HMRC would like to quantify the perceived tax increase if possible, and suggested that, perhaps, no streaming of PB losses under “6 into 1” might mitigate the cost from taxing FII.

2.2 The ABI agreed to collect the following data from its members as part of the exercise proposes in 1.3:

- The FII that would be included in PHI if the “6 into 1” option was adopted.
- The PHI DAC (deferred acquisition costs) included in company balance sheets for 2004 and 2005.
- The difference between the PHI FSA mathematical reserves and the PHI statutory accounts mathematical reserves.

Issue 8: Transitional arrangements with 6:1

3.1 Any transitional provisions due to a possible change in treatment of PHI would be similar to a change in accounting policy (No double counting and no gaps). HMRC would consider any sensible proposal.

Issue 9: Assess GRB under Case 1

4.1 PHI losses presently tended to be used firstly against the long term fund profits, then shareholder fund profits and finally across the group. If a “6 in 1” basis and a Case 1 basis were adopted, the present flexibility of PHI losses would be retained. If a “6 into 1” basis and a Case VI basis were adopted, PHI losses would be carried forward and no immediate loss relief would be available. Moving to a Case 1 basis would probably involve a tax loss to the Exchequer, and HMRC would like to quantify the amount involved. At present a Case 1 basis has not been ruled out by HMRC.

Issue 10: one off election to include PHI in GRB if small or inclusion in GRB if insignificant

Agreed minutes (5/9/06)

- 5.1 It was generally thought that the “5 into 1” option might be a short to medium term possibility whereas the “6 into 1” would be longer term and might need to wait until the apportionment outcome had been decided. At the last meeting the suggestion was made that companies might be allowed to elect for PHI to be included (i.e. adopt a “6 into 1” option immediately). HMRC confirmed that they had no objection to this in principle. Both HMRC and ABI agreed that any such election would be irrevocable.
- 5.2 Difficulties might arise if a company had made such an election to include PHI within GRB (Gross Roll-up Business) and subsequently transferred its long term fund to another company in which PHI business had not been included in such an election. The ABI would not want two systems in one company. ABI members would need to discuss this particular issue between themselves, and revisit this point later.

Issue 4: removal of OLAF categories of assets list

- 6.1 HMRC and ABI are agreed on removing the list of categories of assets (paragraph 4.2 of minutes of 14/06/06 meeting) – see draft legislation which retains “branch assets” as directly referable to GRB and Q15 about currency assets.

Sundry

- 7.1 The following issues identified at the last meeting on 14 June 2006 would be taken forward by other working groups, and so would not be dealt with by this working group:
- **Issue 3:** Any changes arising from consultation ought to be made under primary legislation (Steering group)
 - **Issue 5:** Reclassification of reinsured PB as LRB (Steering group)
 - **Issue 11:** Inconsistency between FSA and HMRC (Steering group)
 - **Issue 12 and 13:** Crown Option (Apportionment)
- 7.2 The next meeting of this working group would take place in about 3 to 4 weeks (date to be arranged in due course).

APPENDIX

<u>Number</u>	<u>ISSUE</u>
1	Validate given: need to ringfence losses (14/6/06)
2	Validate given: actual extent of Exchequer exposure (14/6/06)
3	Any changes arising from consultation ought to be made under primary legislation (14/6/06)
4	Per para 3.6: Industry would welcome removal of OLAF categories of assets list (14/6/06)
5	Per draft clauses: Reclassification of reinsured PB as LRB: Industry would not regard reclassification of products for tax purposes as helpful. (14/6/06)
6	Per Q1: the additional tax arising from inclusion of UK dividends in GRB remains a big issue for the industry (14/6/6)
7	Per Q2: the potential loss of flexibility around PHI losses with 6:1 remains a big issue for the industry (14/6/6)
8	Per 3.18: industry agrees transitional arrangements with 6:1 likely to be complex - would like further details (14/6/6)
9	Industry proposal: given use of Case 1 principles to calculate GRB why not assess Case 1 (rather than VI). If both PHI and GRB could be assessed Case 1, and losses utilised accordingly, objections to 6:1 would fall away. (14/6/6)
10	Industry proposal (alternative): (a) one off election to include PHI in GRB if small (1%) component of business (b) or automatic 6:1 if % PHI below a certain amount. (14/6/6)
11	Inconsistency between FSA and HMRC. (14/6/6)
12	Per Q 24: application of Case 1 would be more acceptable if previous reliefs became available again after application of Case 1 (14/6/6)
13	Industry proposal (alternative): get rid of Crown option but provide that I-E could never be less than Case 1 result (bring in notional BLAGAB income, balanced by increase in XSE carried forward) (14/6/6)