

Agreed minutes (1/8/06)

Transfer of Business Working Group Discussion on 21 June 2006

Summary of Issues and Action Points

Present:

Richard Thomas	HMRC
John Duguid	HMRC
Jeremy Tyler	HMRC
Kate Webster	ABI
Mike Chadwick	Friends Provident
Liz Punchard	Zurich
Andrew Todd	Aviva
Sandy Buchanan	Deloitte
Phil Lewis	KPMG
Matthew Taylor	E&Y
Jonathan Howe	PwC
Mark Downey	Prudential
Lindsay J' Afari-Pak	Herbert Smith

Agreed Objectives

1. The underlying objectives of reducing costs and complexity for business in a tax neutral way, while protecting the tax base, were agreed.

Tax Neutrality for I minus E

2. Section 171 and Sections 139 TCGA offer competing approaches to ensuring capital gains neutrality on a business transfer and apply in different circumstances. Section 211 applies the section 139 approach with its statutory clearance rules and anti-avoidance test.
3. HMRC confirmed they were suggesting that Section 211 should follow the Section 171 approach i.e. tax neutrality would be applied automatically and there would be no need for a "no cash consideration" rule as in section 139. The same s 171 approach would apply to section 444A ICTA; and would, like paragraph 12 Schedule 9 FA 1996 apply to both intra-group transfers, and transfers outside a group.
4. **Issue 1:** ABI raised the question of transfers from shareholders' funds in a Part 7 transfer. It was the view that this was currently within section 211. HMRC expected S171 approach would apply to assets within the section 440(4)(f) category and tax neutrality maintained. But would consider further
5. **Action:** *ABI to give examples of any continuing concerns.*

Case I Issues

6. HMRC proposal was that fair value should apply subject to a section 444AD approach where assets went from one LTIF to another.
7. **Issue 2:** ABI explained that the position envisaged by the FSA Rules (ignoring book value elections) was that assets went at admissible value from one fund to another and that was what was in lines 31 and 32. But the admissible value of the assets could be different in each fund because of different counterparty and concentration limits. If the admissible value of the transferred assets in

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the transferee fund is different there can be tax effects that could impact companies either positively or negatively.

8. If the transfer of business were to be accounted for through lines 31 & 32 at fair value this issue would not arise. ABI want either a nil impact where the assets are accounted for by both parties at equal values or either a negative or a positive adjustment where admissible values are different (i.e. consistency of treatment). However, the ABI still had reservations over the use of fair value in this way.
9. **Action:** *HMRC would like to see paper analysing the tax treatment of such differences.*

Anti-Avoidance Rule

10. HMRC proposal was that tax neutrality and carryover for all aspects of business transfers should be subject to an A-A rule where counteraction was limited to the abusive aspect of the Part 7.
11. **Issue 3:** The ABI's view was that no A-A rule should be required in respect of the tax-neutral carry-across of I-E attributes, which should be automatic (as noted above). There was also a discussion around practical issues with any A-A rule, and ABI were concerned that such a rule might apply where a tax advantage arose but was unintended by the transferor. For example where a (third party) transferee gained advantageous Section 432A fractions as a result of the transfer it would be unreasonable to charge the transferor. A motive test was therefore essential. HMRC confirmed they were not proposing to impose a charge where a tax advantage was only an *effect* of the transaction.
12. **Action:** *HMRC to consider how to structure an appropriate rule reflecting those concerns.*

Policyholder Clearances

13. **Issue 4:** In the case of a court agreed transfer a range of tax clearances are routinely demanded by the Independent Actuary, even where there is no formal clearance procedure, in order to protect policyholders. Commercial realities demand a real time response which is sometimes not forthcoming because of the 30 day rule. Policyholder issues include LAPR, pensions, surplus management expenses, capital gains. Some of them cover cases where legislation is already clear that carryover/tax neutrality available: others such as LAPR less so. ABI's preferred approach is for automatic clearance to apply in the case of a court approved transfer where key conditions are met. This would contrast with the Case 1 approach based on clearance under an anti-avoidance provision.
14. **Action:** *ABI to provide a list of policyholder clearance problem areas. HMRC to consider whether further statutory rules needed to cover clearance areas (and will liaise with pensions etc colleagues)*

Sundry Issues

15. **Issue 5:** It was impossible to liquidate an ex-Life company because of the application of the value shifting and depreciable transaction rules. Yet in some cases it was done apparently without objection which suggested an inconsistency of approach. Applying the SSE Rules (amended for this

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situation) without regard to the 2-year limit might be one acceptable solution for the ABI.

16. **Issue 6:** On a transfer of business it was often desirable for an existing contingent loan to be left in place yet the interaction between Sections 444AE and 83ZA(13), which was flawed, prevented this.
17. **Issue 7:** Section 444AC and other provisions imposed counteraction on transferee or required transferee to obtain info from transferor. Not all transfers were friendly, and warranties were a difficult area. The possibility of an election for tax to be borne by the transferor was one solution suggested by the ABI
18. **Issue 8:** There were two issues with Section 444ACA:
 - If the subsidiary had been in place for a lengthy period then a double tax charge could arise;
 - It imposed an immediate charge rather than the spreading over a number of years which would have otherwise occurred.
19. **Issue 9:** The end of an accounting period is triggered by a small transfer of business. That does not seem to be the right outcome.
20. **Issue 10:** Section 444AA requires a deemed return for the purposes of Section 83(2B) on the transfer of the whole business. Invariably some liabilities and assets are left behind and an amendment to “significantly all of the business” was desirable.
21. **Issue 11:** Section 444AD did not work well on transfers to multiple companies or on third party transactions because the requirement for the transferee to make the election was commercially difficult. Applying it automatically would make more sense.
22. **Issue 12:** Where a composite insurer transfers its Life business but continues to conduct general business the period of account will be brought to an end. That is an inappropriate outcome.
23. **Issue 13:** The effective application of Section 444AD relies upon the transferee accounting for the transfer on line 31. That cannot occur if the transferee is not within the UK regulatory framework.
24. **Issue 14:** The transfer of business is ordinarily not a transaction at arm’s length. Would the UK to UK transfer pricing rules be applied? (HMRC thought there was an assumption that the transfer pricing rules would not override)
25. **Actions:** *ABI to provide a note setting out each of the issues in more detail. It was acknowledged that changes proposed in the Condoc would obviate the need for some of them (see annex for post meeting clarification of this action)*

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Annex: Clarification of action point on issues 5 to 14.

The issues which are not self-explanatory to HMRC are

Issue 5: please explain exactly how the depreciatory transaction rules (identify them please) make it impossible to liquidate a former life insurance company. Why is this a particular problem for ex-life companies?

Issue 6: Please explain, by reference to the statutory provisions concerned, how the interaction is flawed, and what should be done to cure the flaw.

Issue 8 – please explain by reference to the statutory provisions and examples how the double charge arises.

Issue 9 – if section 12(7A) were limited to cases where the whole or substantially the whole of long term business is transferred, would any other provisions need to be amended, and if so which?

Issue 12 – why does it matter? What is the effect of a period of account ending on a LTB transfer where general business continues?

Issue 14 – What particular aspects of a connected parties Part 7 transfer might give rise to transfer pricing adjustments, bearing in mind that Sch 28AA does not apply to—

the section 83(2) return

chargeable gains

capital allowances

loan relationships if paragraph 12 Sch 9 FA 1996 applies (paragraph 12(2ZA))

derivative contracts if paragraph 28 Sch 26 FA 2002 applies (paragraph 28(3A))