

Agreed minutes (17/7/06)

Note of meeting of the Losses and Group Issues Consultation Working Group held on 29 June 2006, commencing at 2.00 p.m. at the premises of the Association of British Insurers (ABI), Gresham Street, London

Present for HMRC

Colin McHardy (CM), CT&VAT, Robert Baird (RB), Large Business Service (LBS)

Present for Insurance Industry

Mike Chadwick (MC), Keith Johnson (KJ), Andy Todd (AT), Nigel Collard (NC), Matthew Taylor (MT) Carolyn Woodroffe (CW), Murray Hennell (MH), Ian Gelley (IG), Liz Punchard (LP) Peter Barrow (PB)

Apologies

Neil McDonald, LBS (sick leave)

Agenda

- 1 Introductions and apologies
- 2 Discussion of "givens"
- 3 Discussion of issues
4. Next meeting – Scotland – 12 July
5. Any other business

Introductions

1. The meeting commenced with "round-the-table" introductions.

Outline of Process & HMRC "Givens"

2. CM went on to introduce the work of the strand. CM thanked the ABI for hosting the current meeting and for their assistance with the consultation process.
3. CM indicated that he would summarise the questions this strand was dealing with, talk through the small number of HMRC "givens", provide any clarification required, then listen to any feedback from the initial ABI group discussions. CM noted that most strands of the consultation, including this one, would be dealing with matters which would read across to the work of other strands. CM noted that he did not want to restrict the discussion, so indicated that delegates should not be inhibited from bringing up matters which might also be relevant to other strands. One of the jobs of the steering and review groups would be to pick-up any cross-cutting points and feed them into a coherent picture of the whole process.
4. CM noted that depending on the ABI views, he might give some initial reactions at this stage, but CM would not be able to give a considered/developed HMRC view today. All points raised today would be taken away for more detailed consideration.
5. CM noted that this strand was dealing with losses and group issues. There were a number of specific questions in the TCondoc on losses but no specific questions on group issues made it into the final version of the TCondoc. However several areas where issues were expected to arise were listed in Chapter 6, which also included a "catch-all" question, to cover issues the insurance industry wished to raise but which were not specifically mentioned in the TCondoc. CM noted that all strands would probably come up with issues via this "catch-all" question. Again, the steering and review groups would co-ordinate here.

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6. CM noted that for the avoidance of doubt, the final Chapter 6 question, on non Directive Friendly Societies, had a sub-strand to itself and would not be covered by the Losses/Group issues strand.

7. It was a “given” that this consultation was looking at the corporation tax treatment of long-term insurance business. It was not looking at indirect tax, inheritance tax or policy holder tax issues. CM indicated that any points which were raised on these issues could be passed on to the relevant specialists elsewhere on HMRC or indeed HMT, but there could be no expectations beyond that for points outwith the scope of the TCondoc.

8. It was also a “given” that we were considering maintenance/improvement of the current I minus E regime, not replacement of it, which would be a policy development matter for HMT to consider in the first instance. However, there was no bright line between policy maintenance and policy development. If in doubt, CM asked that points be raised. If they turned out to be policy development issues, they would be passed to HMT. Again there were no expectations beyond that for points found to be outside the scope of the TCondoc.

9. It was also a “given” that section 83(3) would not survive in its present form. However, whether it was to be repealed, amended or replaced remained open for discussion

Summary of questions

10. TCondoc Chapter 4 had two specific questions on losses

Question 4.17 looked at alternatives to section 83(3). Two options were given.

(i). Leave the position as it is at present, but isolate and allow losses arising from “new business strain”, making the connection between the loss and the transfer more obvious.

(ii). Complete repeal of section 83(3) and replacement with more specifically targeted provisions, for example explicit disallowance of special bonuses or other payments comprising some/all of the cost of acquiring an interest in a company.

The TCondoc also asked whether there were any other options for dealing with section 83(3).

11. Question 4.18 asked whether in the context of a total repeal of section 83(3), life insurance losses to be surrendered to a company which wasn't carrying on life insurance business should be measured with respect to the accounts rather than the regulatory return. This was not an absolute given from HMRC, but it was a strongly held view. Q4.18 also asked whether it made sense to extend this approach to all section 434A situations.

12. Chapter 6 did not pose specific questions, but indicated that issues were expected to be raised around

- Structural assets and income arising therefrom
- Connected party losses arising from unit trust units or OEIC shares disposals
- Interaction of offshore fund, CFC and section 212 issues

Chapter 6 also included a general “catch-all” question.

13. CM noted that he would prepare a note of meeting, which would be shared with the ABI for comment and amendment.

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Discussion of Issues

14. MC noted that he saw two distinct issues, namely (1) utilisation of losses and (2) dealing with section 83(3). On the first issue, insurers were traders, so there was no anomaly with the surrender of losses as group relief, and SP 4/95 fixed the starting point for the measure of the losses as the regulatory return.

15. The insurance industry was not attracted by a move to use accounts as the starting point for computation of losses. There were a number of problems in obtaining a consistent measure and the area was currently in a state of flux, with the developments in IFRS. In that regard, it was not yet compulsory for subsidiaries to report on an IFRS basis. There might be a case for change to an accounts basis at sometime in the future but not at the present time, when the outcome of the IFRS changes remained uncertain. Nor, for the same reason, was it thought appropriate to cap the loss which could be surrendered to non life insurers at the accounts measure of the loss.

16. MC noted that no similar restrictions were made elsewhere in "UK Plc" where different companies within a single UK tax group would use different accounting policies.

17. CM was asked to clarify whether it was the ability to surrender losses as group relief or simply the measure of the loss which could be surrendered which was under discussion. CM confirmed that it was simply the measure which was under discussion. There was no move from HMRC to prohibit surrender of group relief by life insurance companies.

18. Moving on to section 83(3), the insurance industry understood that HMRC had a problem where artificial losses were concerned. However, 83(3) was a blunt instrument with a very wide impact. For example, it did not specify a time limit, and uncertainty this created was an issue. It was also noted that the provision applied for total reinsurance as well as for a transfer of business, and designing a solution to cover both of these situations could be problematic. However, it was taken as a positive step that section 83(3) would not remain in its current form.

19. It was accepted that in some cases artificial losses did arise, but distinguishing them from real losses was a difficulty.

20. The first approach outlined in the TCondoc, it was thought, would still catch and disallow "innocent" losses, for instance those arising from the collapse of the investment market. This approach would also leave considerable uncertainty, and was not thought to be specific enough.

21. While the second approach mooted in the TCondoc would still leave a level of uncertainty, and a suitable mechanism to stop artificial losses would need to be devised for this approach to work, the second approach was the initial preference of the insurance industry.

22. For example, it was noted that mismatches in valuation basis between transferor and transferee could give rise to losses, due to differing discount rates, and it was unfair to catch such situations.

23. MC asked whether HMRC could set out its main concerns which it was looking to block via section 83(3), in anonymised form. CM said he would consider this, but it might prove difficult, as cases might be recognisable, even if issues were described on an anonymised basis.

24. The ABI wondered also whether any successor to section 83(3) could include a motive test and clearance procedure, which would give the CRM early sight of the facts.

25. Again it was noted that it might be straightforward to take a motive test approach with a transfer, but a total reinsurance would be more difficult to deal with.

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26. MT wondered whether HMRC's main concern was ensuring that no allowance was given for payments to policy holders which were effectively compensation for having some or all of their interest in the company acquired by a third party. CM confirmed that this was indeed HMRC's main concern.

27. MC noted that the insurance industry accepted that a transfer of business and an associated loss might not occur simultaneously, but questioned the need for a provision without any time limit. The insurance industry would like a time limit and initially proposed two accounting periods after the transfer.

28. MT noted that where transfer scheme documentation provided for support of with-profits funds, any losses arising from this should not be within the ambit of a revised section 83(3).

29. PB noted that section 83(3) had been on the statute books since 1995, and some of the abuses initially targeted by section 83(3) were now covered by other legislation introduced later, for example some of the transfers of business provisions. On a related point, MT noted that section 83AA didn't work well (it wasn't clear for instance whether it applied to both case I and case VI) nor did section 83AB. And any change would have to take account of those cases with a section 83AA "bank" carried forward.

30. MC also raised the issue of fairness, whereby current cases were being tackled under section 83(3) when S83 (3) would be changed or eliminated going forward. MC wondered whether current cases could be dealt with more sympathetically, given the changes in prospect in the near future. CM noted this would be difficult, and the law today would have to be applied as it stood today, notwithstanding that the law might change tomorrow. CM also noted that such an approach could result in a "freeze" on LBS cases and that could not be allowed to happen.

31. LP noted that life insurers were excluded from most of the intangible assets legislation, and wondered whether relief could be introduced for life insurers buying intangible assets such as goodwill, thereby giving life insurers parity with the intangibles regime applying to other companies.

32. MT noted from the discussions of the transfers of business strand, that most of the current transfers of business legislation had been written to counter transfers within a group, while the legislation didn't work so well with third party transfers, which would be an increasing feature in the future.

33. MC also noted that the insurance industry had other issues around loss utilisation, and was looking for parity with the rest of "UK Plc", and in particular was looking for parity between life and non-life insurance. The insurance industry would like to see a one year carry-back against prior year GRB profits for current year GRB Case VI losses. The industry would also like to see one year carry-back of BLAGAB excess E to BLAGAB excess I of the preceding year.

34. Also, where a group carried on life insurance business across several life insurance companies, the industry would like parity with groups which carried on a similar mix of business within a single large life insurance company. To meet this aim, the industry would like to see relief of BLAGAB excess E in-year against BLAGAB excess I in the same year within other life insurers within the group. Industry would also like to see surrender of current year GRB Case VI losses against current year GRB profits in life insurers elsewhere in the same group.

35. HMRC did not completely rule out these points, but pointed out they would have a cost and the current package was intended to be cost neutral. RB asked whether the life industry had any costings for these reforms, but no such data had been compiled.

36. Turning to group issues, the carry back of section 212 deemed disposal losses from the transferee back through a Part VII transfer are possible under current legislation. The

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provisions work if the transferee is a new company but don't operate where the transferee has existing business. Industry would like this issue to be tackled.

37. Industry would also like to see a reduction of the percentage required to invoke the substantial shareholdings exemption. CM noted on this point that an "amnesty" had been offered, prior to the introduction of substantial shareholdings legislation, to allow groups to restructure. However, this has not been taken up. MC noted that the life industry had not liked the conditions attached to the proposed "amnesty", which is why it wasn't taken up

38. As HMRC anticipated, the insurance industry found the interaction between offshore funds/CFC/section 212 problematic as this could lead to double or even triple charges, where the offshore fund did not pursue an acceptable distribution policy. It was accepted that in practice, inspectors would not seek to charge income more than once, but in the context of CTSA it would be helpful if companies could file on this basis with certainty.

39. Section 434A (2ii) and sections 442 to section 444 were mentioned as possible candidates for scrapping, as being obsolete.

40. The insurance industry would also like to eliminate the anomaly whereby there was no group income exception for dividends paid by a subsidiary of the long-term fund. It was also felt that in most cases, subsidiaries of a long-term fund were not supporting policy holder liabilities.

41. It was noted that the application of connected persons losses rules to disposals of unit trusts or OEICs under section 440 could lead to anomalies. This would particularly apply if the group subsequently disposed of its fund management company. Due to the operation of Section 440 and an arms length disposal value, the connected party rules should be disapplied.

42. CM noted that if the industry was looking for parity with "UK Plc" on losses, it would also be necessary to put on the table issues like streaming of losses following a section 343 transfer.

43. MC raised the point, in the context of streaming pension business losses post-amalgamation, of whether Pension Business losses really were still a problem for the exchequer. It was accepted that there were large amounts of pension business losses around in 2002, but the industry felt that much of this had been relieved against profits in later years. CM noted that his latest figures (2003) showed that Pension Business losses increased in that year. 2004 figures would be available soon, and it was something the "consolidation" consultation team were looking at. MC made the point that even if there was still a substantial amount of Pension Business losses around, profits in the other GRB categories were small, so there might not be too much tax at stake on streaming anyway.

Next Steps

44. CM noted that he had heard the industry's views, and would consider these. The group would discuss the position further at the next meeting, on 12 July, in Edinburgh

45. KJ noted that many of the issues discussed were timing issues only. CM noted that might be true in the case of a company carrying on business continuously from inception through run-off, but events such as a transfer of business could change timing issues to permanent exemptions!.