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## Tax Matters in Relation to the Reattribution

A summary of Aviva's proposals in connection with the reattribution of the inherited estates of CGNU Life and CULAC with-profits funds

Norwich Union formally rebranded as Aviva in the UK on 1 June 2009. Where an historical position or events prior to 1 June 2009 are described in this appendix, 'Aviva' and associated naming conventions have been used. Financial information has not been updated and remains as at the time of the report date.

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Appendix by: Aviva UK Life – June 2009

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## 1.00 Context

In order for the various stakeholders to make an informed decision they will need to understand how the tax implications might inform their decisions.

This appendix aims to share our assessment of these considerations, their impact on customers and on the tax position of the life funds. The appendix also describes the safeguards which are designed to assist in managing tax changes in the future.

This appendix constitutes research undertaken by Aviva in good faith for its own purposes. It is intended only as a general overview to certain aspects of United Kingdom tax legislation and what is understood to be current practice of HM Revenue & Customs in relation to matters relevant to the reattribution. As such it does not constitute tax or legal advice to any person and may not be relied upon as such. Policyholders who are in any doubt as to their own tax position or who are resident in (or otherwise subject to taxation in) a jurisdiction outside the United Kingdom, should consult their own professional advisers.

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## 2.00 Categories of Tax to be Considered

When considering the tax implications we looked at the impact on both policyholders and the value of the fund.

Policyholder tax considerations fall into the following categories:

- Tax on the Policyholder Incentive Payment (PIP)
- Tax on Bonus Distributions
- Non-Electing Policyholders Tax position

Value of the fund tax considerations fall into the following categories:

- Tax Considerations Affecting the transaction
- Embedded Value Tax Modelling

### 2.01 Tax on the Policyholder Incentive Payment

PIPs can be paid either in cash or added to the policies as additional benefits. There are different tax implications in each case.

Our expectation is that most people would prefer their PIPs paid in cash. In the event that this isn't desirable, for legal or tax reasons, Aviva will make an additional benefit allocation ("non cash PIP") to the policy.

Further details on the criteria for the PIP will be set out in the appendix "The Aviva Offer".

The anticipated tax impact for UK resident Life and Pension policyholders is described below.

#### 2.01.01 UK resident Policyholders – Cash PIPs

HM Revenue & Customs have confirmed that a cash PIP will not be subject to income tax or capital gains tax unless:

- It is in respect of a life policy acquired from the original policyholder, for example a second hand endowment, in which case it will be subject to Capital Gains Tax (CGT), or
- It is in respect of a life policy held as an asset of a taxable trade, in which case it will be subject to tax on income.

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### **2.01.02 UK resident Policyholders – Non Cash PIPs**

A non cash PIP paid added to a life policy will be taxable or exempt in the normal manner as part of a subsequent 'chargeable event', such as a surrender or maturity payment. This depends on the individual's tax profile and the policy's qualifying or non-qualifying status.

A non cash PIP added to a pension policy will be taxable as part of the normal process when the benefits are paid out.

### **2.01.03 Tax Status of Policies**

Neither the reattribution nor payment of a cash or additional benefits PIP will affect the qualifying status of any qualifying policy or the registered pension status of a pension policy.

### **2.01.04 Policyholders resident in Jersey, Guernsey and Isle of Man**

We have confirmed with the local tax authorities in Jersey, Guernsey and Isle of Man that no tax will be charged on receipt of a cash PIP.

### **2.01.05 Policyholders resident elsewhere**

Our analysis of policyholder address files show that we have numbers of policyholders living in a variety of different countries. Given the spread of countries, it would be impractical to obtain advice in sufficient detail to give an understanding of how each of these nations would tax the PIP. Nevertheless, it seems likely that in many cases the receipt of a cash PIP would be subject to local income tax on residents.

In those countries where tax is payable, the rules are complex and depend on policyholder circumstances. Accordingly policyholders are advised to seek their own local tax advice before deciding whether to elect for reattribution.

In most cases the addition of a non cash PIP to a policy appears not to result in an immediate tax charge. On the other hand the resultant policy gain is taxable on maturity, or equivalently in relation to pensions.

### **2.01.06 Corporate Policyholders**

Companies who hold eligible policies should seek professional advice on the tax consequences for them before deciding whether to elect for reattribution.

## **2.02 Non-Electing Policyholder Tax Position**

Neither the transfer nor the reattribution will affect the tax position for non-electing policyholders.

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### **3.00 Tax Considerations Affecting the Transaction**

The value created for shareholders by the transaction, amongst other things, could be affected by the assumptions described below.

In this document we will outline the assumptions in relation to these topics.

The value of the reattributed inherited estate to the company is reduced by:

- The tax payable on the investment earnings of the estate assets prior to release
- The tax payable on the release of the inherited estate as surplus

#### **3.01 Tax payable on the release of the Estate as surplus**

The reattributed inherited estate will be transferred for tax and regulatory purposes to the Non Profit Sub Fund (NPSF) of Aviva Life and Pensions (AVLAP). Tax will be payable on any releases of surplus made from the reattributed inherited estate. Based on current law, the tax rate payable will be based on the proportion of non-linked life and pensions business in the NPSF at the time of the release which will be at least six years after the Effective Date of the reattribution.

This charge could be increased or decreased or accelerated depending on changes to tax law or to the mix of business between now and the time of release.

#### **3.02 Tax payable on the investment earnings on the estate prior to release**

The investment return on the reattributed inherited estate assets will be taxed whilst it is in the non-profit fund.

The tax charged to the reattributed estate will be calculated under the tax calculation provisions of the Scheme as if it forms part of the New With-Profits Sub Fund. The tax charged will depend upon the assets held in the reattributed estate.

#### **3.03 Corporation tax deduction for the PIP**

The cash PIP will be paid by a shareholder fund or company. No corporation tax relief is available for cash PIP's.

The non cash PIP will be paid into AVLAP from a shareholder fund or company (by contingent loan or otherwise), and/or paid into the New With-Profits Sub Fund from surplus in the AVLAP Non-Profit

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Funds which would otherwise have been available to transfer out of the long term fund and which could have been distributed to shareholders without causing AVLAP to be in breach of capital requirements.

A corporation tax deduction will be available for the non cash PIP.

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## 4.00 Scheme Provisions Relating to Tax and their Safeguards

The tax provisions are set out in Chapter 5.11 and 7.2.3 of the Scheme.

These sections provide for stand-alone tax calculations and charges for the:

- New With-Profits sub-fund (NWPSF)
- Old With-Profits sub-fund (OWPSF)
- Reattributed Inherited Estate External Support Account (RIEESA)
- Provident Mutual (PM) fund
- Existing AVLAP With-Profits funds

This means that these funds, or the RIEESA, will be charged with the tax that they would have paid had they been separate entities, but the tax charged to the RIEESA will be calculated on the basis that the NWPSF and the RIEESA together constitute a stand-alone with-profits fund less the tax charged to the NWPSF if it had been calculated on the same basis.

In the event that tax is not allocated to one of the above funds (or the shareholders fund) through the stand-alone calculations there will be an outstanding balance. The balance will be charged or credited to the non-profit funds of AVLAP (outside the RIEESA).

Subject to the next point, this means that the non-profit funds of AVLAP take the benefit or bear the cost of synergies or dissynergies (respectively) which arise between the different funds. The KPMG modelling concluded that any synergies or dissynergies are not expected to be material over time.

Changes to these rules, e.g. as a result of law changes which render the existing allocation unfair, or material tax synergies arising which benefit the non-profits funds, may be made subject to:

- The AVLAP Board considering it appropriate to do so; and
- With-Profits Committee approval.

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## 5.00 Tax Impact on the Fund

Because of the complication involved, we engaged a firm of accountants, KPMG LLP, to help us model over 25 years the impact of the transfer and reattribution on the tax position of AVLAP and its sub funds.

This analysis concluded that the effect was broadly neutral.

A copy of the summary report produced by KPMG LLP has been shared with the Office of the Policyholder Advocate and their tax advisors. In addition, we have provided additional analysis and information in response to their specific requests for information.

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## **6.00 Tax Assumptions when Considering the Value of the Transaction**

### **6.01 Effective rate of Tax on Shareholder Transfers**

The effective rate of tax applicable to future transfers of the reattributed inherited estate to shareholders will be dependant upon the mix of business in the combined non profit funds of the company at the time of the transfer. The long term effective rate based on forecast future business mix is 17.5%. The effective rate which would have been applicable to such transfers in 2008 would have been 19.6%, reflecting the actual business mix during the year.

### **6.02 Frictional rate of Tax on RIEESA Investment Return**

For the purpose of estimating the value of the transaction, Aviva has assumed a blended frictional tax rate of 6.9% will be applied to investment earnings on the reattributed inherited estate assets.

The tax rate has been estimated based on the forecast asset mix of the fund and taking into account different rates of tax applicable to the investment returns from different classes of asset. The frictional tax rate for such earnings during 2008 would have been 10%.

### **6.03 Provision for Tax on Future Shareholder Transfers in the Realistic Balance Sheet (RBS)**

In line with the permitted uses of the inherited estate under the Financial Services Authority (FSA) conduct of Business Sourcebook (COBS) rules and the CGNU Life and Commercial Union Life Assurance Company (CULAC) Principles and Practices of Financial Management (PPFM), the published realistic balance sheets for CGNU Life and CULAC make a combined allowance for tax on future shareholder transfers of £120 million at 31<sup>st</sup> December 2008.

This (amongst other figures) is taken into account when assessing the value of the transaction to shareholders. Further information can be found in the "Valuation of the Reattributed Estate" appendix.

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## **7.00 Aviva's view of the Policyholder Advocate's Approach**

### **7.01 Assumption Differences used in the Negotiations**

In their paper the Office of the Policyholder Advocate has highlighted some assumption differences between the bases used by Aviva and the Policyholder Advocate when assessing the possible value of the transaction for shareholders.

Notwithstanding these assumption differences, the Office of the Policyholder Advocate and Aviva are satisfied that the offer is in the interests of the vast majority of policyholders when compared against a wide range of scenarios.

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## 8.00 References

- The Aviva Offer
- Valuation of the Reattributed Estate
- Scheme