

Charging structure and tax note from Deloitte

Our response is below. As mentioned in previous correspondence the use of a charging model for secondments wasn't purely a tax consideration so hence this note covers the full rationale.

Challenge:

Why is a charging model required at all?

Response:

The NBB and the FSMA have been very specific on their expectations concerning LIC's control and supervision of secondees. They would like LIC to demonstrate a direct link between secondees performance and remuneration. The total absence of remuneration could be perceived as impacting the substance of the arrangement with the risk of viewing the set up as artificial and LIC not providing sufficient oversight. The regulator is keen to see that the new operational model doesn't only exist by design, but is also effective. Their optimum set up would be a joint employment contract with LIC directly remunerating the underwriters. We believe this is impractical and so have come up with a middle ground which satisfies the control and oversight requirements but minimises administrative impact on the underwriters and Managing Agents. The intention is to adopt a secondment arrangement which is as close as possible to what would be found within an employment contract. The charge demonstrates that there is an activity performed on behalf of LIC (as LIC wouldn't pay if it wasn't receiving any support) and it demonstrates that LIC has the mechanism to impose its expectations of the secondees (as the payment could be used as a leverage if performance is not up to standard).

There are also two key considerations from a tax perspective:

- There was a risk that the remuneration costs for underwriters seconded to LIC would not be deductible for corporate tax purposes in Managing Agents'/Members' accounts if no charge was made (on the basis that Managing Agents/Members might not be able to evidence that the remunerations costs were incurred wholly and exclusively for their trade). The introduction of the charge mitigates this risk.

There was also a risk from a VAT perspective that HMRC would argue that a 'barter' transaction was taking place between the Managing Agents and LIC UK branch in the absence of any charge for the secondments. If HMRC were successful, this could have crystallised a VATable charge in both the Managing Agents and LIC UK branch. By introducing a charge, we have removed this risk of challenge by HMRC and only have a single VATable charge being made to LIC UK branch. The additional administration of VAT invoicing on the Managing Agents will be mitigated by the use of self-billing (such that LIC UK branch will create the invoices on the Managing Agents behalf) and, as we expect the branch to secure nearly full VAT recovery, any additional VAT cost will be minimal.