FEC MUTUAL - MUTUAL TRADING

PROPOSED AMENDMENT TO THE ARTICLES

Proposed Articles Update (as detailed in the AGM Brochure).

ARTICLE 1. INTERPRETATION

“Financial Year” means a year commencing on 23rd October or any other date so designated by the board

ARTICLE 42. WINDING UP

In the event of the winding up of the Mutual, after its liabilities have been satisfied, the remaining assets of the Mutual shall be distributed by reference to the Liquidation Proportion of each eligible Member, calculated as follows:

> The Liquidation Proportion of each eligible Member shall be a fraction (a) the numerator of which is the sum obtained by aggregating the amount of the contributions paid by such Member for the financial year in which the winding up is commenced or if earlier the last financial year of the Mutual in respect of which the Mutual issued any Certificates of Membership under the Rules ('the last financial year') and (to the extent applicable) for the four preceding financial years and (b) the denominator of which is the sum obtained by aggregating the sum obtained pursuant to (a) hereof in respect of all eligible Members (such fraction being expressed as a percentage to two decimal places).

A person shall be an eligible Member and entitled to participate in a distribution to be made pursuant to this Article if the person was a Member of the Mutual during the last financial year of the Mutual or (to the extent applicable) at any time during the four preceding financial years.

Explanation of the rationale for the changes detailed above (and the need for the Special Resolution).

Mutual trading requirements – surpluses

1. A mutual trader is not liable to pay corporation tax on trading profits which arise from their mutual trade.

2. HMRC's Business Income Manual sets out the requirements for mutual trading. These include the requirement that *"there is complete identity, as a class, between the contributors to a mutual surplus and the participators therein"* (BIM24105).

3. This principle is referred to by Lord Macmillan in Municipal Mutual Insurance Limited v. Hills, [1932] 16 TC 405:

> *"The cardinal requirement is that all the contributors to the common fund must be entitled to participate in the surplus and that all the participators in the surplus must be contributors to the common fund; in other words, there must be complete identity between the contributors and the participators. If this requirement is satisfied, the particular form which the association takes is immaterial."*

4. Members (contributors) can come and go of course, but at any given point in time, the persons who are contributing to the surplus must be identical to the persons who are entitled to participate in the surplus.

5. There is no requirement that the surplus or part of it must go back to the contributors as and when the surplus arises; the requirement is that on a winding up the surplus goes back to the contributors: BIM 24115.

6. As to how to work out how much of a surplus should go to each contributor, BIM24115 also says:
    a. *"The proportion* (of the surplus) *returned to each contributor (current and past) must bear a reasonable relationship to the contributor's (or former contributor's) contribution to the surplus.*

    b. *"… an entity satisfies this condition if the return of contributions only takes into account current contributors and those who ceased to be contributors within the last five years."*

The Articles of Association

7. The Mutual's Articles do not contain any provisions as to the distribution of any surplus on a winding up. This is the improvement the suggested items intend to rectify. See point 10 below.

8. Several UK Mutuals have a formula for calculating a Member's share of the surplus on winding up. The formula provides for a percentage distribution for each applicable financial year.

$$\frac{\text{individual member's contributions}}{\text{total contributions}} = \text{X.XX\%}$$

9. The calculation is made for the financial year in which the winding up commences and (where applicable) the preceding four financial years. It therefore complies with the HMRC requirement referred to in paragraph 6.b above

10. A new Article 42 needs to be added. This will also require the addition of a new definition of "Financial Year" in Article 1.

Tower Insurance Brokers