

TAX BRIEFING

INTRODUCTION

This edition of *Tax Briefing* is devoted exclusively to what can be fairly described as a treatise on the "*Taxation of Lloyd's Income and Gains in Ireland*".

While the main focus of the treatise is on the tax treatment for 1995/96 the treatise also covers such matters as:

the fundamental principles by which Lloyd's Names are taxed

the changes which resulted from the introduction of Self Assessment and finally

the impact for Irish Taxation of the changes introduced in the 1993 UK Finance Act.

Enquiries by practitioners on this publication or, on any other aspect of the taxation of the income or gains of an individual Lloyd's Name may be made to that Name's Inspector of Taxes.

Names are requested when filing their **Tax Return**, to include the **annual Double Taxation Report** issued to them by Lloyd's Central Services Unit (CSU).

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The Treatise and its Contributors

The contents of the treatise have been approved and agreed by Revenue with the Irish Taxation advisor to Lloyds and with Lloyds Taxation Department.

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and

Mr. Denis Holligan of the Office of the Chief Inspector of Taxes who, in addition, co-ordinated the material and presented it for publication.

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accepted for any liability incurred or loss suffered as a consequence of relying on any matter published herein.

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TAXATION OF LLOYD'S INCOME AND GAINS IN IRELAND

1. The UK Permanent Establishment

All Members of Lloyd's are deemed to be trading through a permanent establishment in the UK and consequently are liable to UK tax on the income and gains connected with the permanent establishment. The rules governing the assessment to UK tax of Lloyd's income and capital gains are contained in the UK Income Taxes Acts and associated Regulations.

2. Definition of the Lloyd's return

A Name's return from Lloyd's falls into three distinct categories which are :

- **underwriting profit or loss (including syndicate investment income)**
- **capital appreciation**
- **income and gains arising from the Funds at Lloyd's**

Each of these categories is dealt with separately below.

3. Underwriting profits and losses

3.1 *Basis of assessment*

Underwriting profits or losses are assessed in the income tax year following the close of the underwriting account - in effect for the year of distribution.

For example, a profit or loss for the 1992 Account, closed 31 December 1994 and distributed six months later in June 1995, is assessed for 1995/96.

The income is reportable on the tax return covering the year of assessment of the income.

The 1995/96 income tax return must be lodged with the Irish Revenue by 31 January, 1997.

In practice, Names should have sufficient information to meet this reporting deadline.

The profits or losses are treated as arising from a separate Case III source assessable according to the rules of Case I.

The Lloyd's account is treated as co-terminus with the year of assessment for tax purposes. Thus, a Name whose first

underwriting year is 1992, closed on 31 December 1994, would be firstly assessed on this income for 1995/96.

Because the account is regarded as co-terminus with the year of assessment the apportionment normally associated with commencement situations is not required.

Similarly, a Name ceasing to underwrite and whose last underwriting year is 1992, would have a final year of assessment covering his Lloyd's income for 1995/96.

As Names are taxed on a quasi-actual basis no revisions occur on the cessation.

3.2 *Taxable amount*

The underwriting profit or loss assessable can be identified from the taxation advice which Lloyd's Central Services Unit (CSU) issues - a copy is attached as **Appendix I**. The relevant figure is the gross profit or loss shown on Line 14.

This gross profit or loss figure will require further adjustment to take account of:

- (i) personal expenses deductible for Irish taxation purposes which are not included on the taxation advice - such as stop loss premium and letter of credit costs.
- (ii) non-syndicate income such as stop loss recoveries.

Once these adjustments have been made, the underwriting profit or loss can be reached.

3.3 *Treatment of Lloyd's expenses*

As indicated above, relief may also be claimed for certain expenses which the Name has paid personally. Such expenses will typically include letter of credit and bank guarantee charges, stop loss insurance premiums, ALM subscriptions and expenses, accountancy fees and interest on loans to fund underwriting losses. Documentation in support of the claim should be provided.

In addition, further expenses may also be deductible - for example, travelling costs. Travel and accommodation costs in attending meetings of the Association of Lloyd's Members in Ireland are allowable provided the Name can satisfy the Irish tax authorities that the expenditure was incurred wholly and exclusively for the purposes of the trade. Documentation in support of the claim should be provided.

The Irish Revenue consider that the cost of travel between a Name's home and London is not allowable as the trade is carried on in London.

They may, however, be prepared to allow relief for the cost of overnight accommodation in London if it can be demonstrated that it is a necessary business expense which satisfies the wholly and exclusively test.

3.4 *Allowance for Irish Accountancy Fees*

Whilst recognising that the UK Accountancy Scale covers the allowable tax and accountancy expense required to produce the UK taxable result it is acknowledged that additional work is necessary in Ireland to adjust the UK figures for the purposes of reporting in Ireland.

To avoid the necessity of analysing Irish accountancy bills an allowance based on the UK scale has been agreed whereby one third of the permitted UK scale is allowed as an expense in addition to the scale charge.

3.5 Foreign Tax Credits

There are three categories of foreign tax which might have been deducted from underwriting profits:

non-US or non-Canadian income taxes paid on certain overseas premiums,

US and Canadian Federal Income Taxes,

UK tax.

Credit relief is available for all these foreign taxes in computing Irish income tax, subject to the usual limits/rules.

Where credit relief has been claimed for any foreign taxes which are subsequently refunded, then an appropriate adjustment to the original claim will need to be made. Credit relief for foreign taxes should be restricted to take account of any anticipated refunds of foreign taxes. The expression of doubt provisions of Section 14(4), Finance Act, 1988 can be applied, where circumstances permit.

Non-US or Non-Canadian income taxes

The taxation advice shows foreign taxes, apart from US and Canadian taxes, on Line 22. These foreign taxes will already have been taken into account on the taxation advice as a deduction in computing the underwriting profit or loss. Where there is an overall profit it will have to be added back for Irish tax purposes and credit relief claimed, subject to effective rate computations, etc.

US and Canadian Federal Income Taxes

Credit for US and Canadian taxes will also be available. The figures in relation to US and Canadian taxes on income (as opposed to capital gains) will be available from the CSU double taxation relief report which is produced annually.

The CSU produces a double taxation relief report and the figure available for relief will be shown on this report.

UK tax

Credit for UK tax - both basic and higher rate (where relevant) - is due subject to the normal rules.

3.6 Preliminary Income Tax Payments

Lloyd's income must be taken into account when the preliminary income tax payment is calculated.

If the taxation advice has not been issued when the preliminary tax payment is due, the personal consolidated statement (distribution account) should be used instead. Please note that the result shown in the statement does not take account

of any adjustments that are needed for UK taxation purposes but it should, for the majority of Names, give a reasonable indication of the taxable result.

Names, when computing their preliminary tax payment, should remain conscious of the interest penalties that can arise

if the payment does not constitute either

- 100% of their liability for the preceding income tax year, as adjusted where required by legislative changes,
- 90% of their finally computed liability for the income tax year in question,
or
- 105% of their liability for the pre-preceding income tax year, where the Name has entered into an arrangement with the Collector-General to pay preliminary tax by “direct debit.”

3.7 Loss relief

Any losses arising from a Name's underwriting activity are available for relief under Section 307, Income Tax Act, 1967. In addition terminal loss relief is available on a cessation under Section 311, Income Tax Act, 1967.

A Name, with underwriting losses, is entitled to raise with his/her local Inspector of Taxes the possibility of having current loss relief coded into his/her certificate of tax free allowances, subject to being able to provide appropriate objective back-up in the form of CSU taxation advice. Loss relief will only be given insofar as the losses can be expected to exceed any other income of the Name which is taxable by way of direct assessment. This is on the basis that a Name can in effect claim relief in relation to such income via his/her preliminary tax payment.

Pre-1986 account underwriting losses forward can also be offset against pre-1986 syndicate investment income, insofar as these losses are based on agreed figures and there is no reopening of closed years.

Any losses arising from a Name's underwriting activity, insofar as not relieved under Section 307, Income Tax Act, 1967, may be carried forward for offset against future Lloyd's underwriting profit.

Special transitional rules applied in relation to losses incurred in the 1985, 1986 and 1987 underwriting Accounts. These rules are considered further in Paragraph 3.10 below which deals specifically with the transitional provisions.

3.8 Retirement annuities

A Name's underwriting profits are only treated as earned income for retirement annuity purposes, where that Name is a "**working Name**". A "working Name" broadly speaking is one who spends on average, throughout the tax year, at least 75% of a normal working week actively engaged in the business of Lloyd's, e.g. in the office of an underwriting agency or Lloyd's broker.

3.9 Currency conversion

The Sterling results should be translated into Irish pounds for tax purposes at the sterling selling rate on the last market day of the calendar year of closing. Thus, the results for the 1992 Account, closing on 31 December, 1994, should be translated into Irish pounds at the rate as at 31 December 1994. This method of conversion should be applied consistently from one year to the next.

3.10 Transitional rules

The introduction of self assessment in the Finance Act, 1988 resulted, in a radical revision of the agreed treatment of Irish Names for Irish tax purposes.

Lloyd's profits, up to and including the 1984 Account, were dealt with under the old rules which broadly followed existing UK basis of assessment rules.

However, from and including the 1985 account, the new rules (as outlined in the preceding paragraphs) applied. There are a number of consequential transitional rules arising from this change.

For a Name engaged in underwriting activities prior to 1984, and who continued to be a Name, no assessment of Lloyd's profits were made for the years 1985/86, 1986/87 and 1987/88. The profits for the 1985, 1986 and 1987 Accounts are instead assessed in 1988/89, 1989/90 and 1990/91.

To take account of this change in practice, certain transitional rules exist for Names who incurred losses in any of the 1985, 1986 and 1987 Accounts. These Names have the option of claiming relief for the losses in either:

1985/86, 1986/87 or 1987/88;

or in

1988/89, 1989/90 or 1990/91 respectively.

Each year is looked at independently. Therefore, if a Name wishes to claim a loss in the 1985 Account as a 1985/86 loss, he/she may opt to claim relief for a 1986 Account loss as either a 1986/87 or as a 1989/90 loss (but not both). This is subject to the time limit rules on losses.

3.11 Immigration / Emigration

Many of these cases will arise in situations where the Name is either coming from or going to a country with which Ireland has a double taxation agreement.

Immigration

In the case of immigration the Name will generally be within the Irish tax net from the time of taking up residence in Ireland. Thus, a Name taking up residence in Ireland in 1995/96 would be assessable by reference to the Lloyd's 1992 underwriting year.

If losses arose in that year these would be deductible against subsequent underwriting results, subject to the normal rules. Tax credit relief should generally be available under most double taxation agreements.

Emigration

Similar issues will also arise in the case of emigration. In the vast majority of cases it is expected that emigration will generally fall to be dealt with under the relevant double taxation agreement, which would obviously dictate the appropriate treatment.

The Revenue's approach in the case of emigration to non-treaty countries is as follows:

- Generally, Names who emigrate will continue to be charged to Irish income tax at the standard rate, with any tax credit relief confined to that rate, for each of the three years following emigration. Thus, a Name emigrating in 1991/92 would remain assessable for tax years up to and including 1994/95 covering underwriting years up to and including the 1991 account.

3.11 Continued

- However, it is recognised that this approach would give rise to anomalous results in Ireland where a Name had been resident for a period of, say, less than six years. For example, a Name resident in Ireland for three tax years might under the above treatment be assessable for six tax years, covering six underwriting accounts. These situations will be dealt with by the Revenue on a case by case basis, the general intention being to ensure that the Name is not assessable for years in excess of those of actual residence.

3.12 Deceased Names

A deceased Name will be taxed in the year of assessment in which death occurs following the normal rules outlined at

Paragraph 3.1.

Thus, a Name dying in January 1995 will be assessable for 1994/95 on the results of the 1991 underwriting account.

Certain underwriting accounts will not be closed at the time of death and therefore some profits or losses will remain

to be established for the Lloyd's activities.

The latter income will be assessed on the executors for each of the subsequent years of assessment for which underwriting profit or losses remain to be determined. Thus, in the example given above, the executors would be assessable for 1995/96 on the results of the 1992 account, for 1996/97 on the results of the 1993 account and so on. Personal allowances and reliefs would not be available.

Where a deceased Name has underwriting losses carried forward as at the date of death, these may be carried forward

to his/her Executors for offset against any subsequent underwriting profits assessable in their name.

Terminal loss relief will also be available to the Executors on losses arising in the final year of assessment of Lloyd's

income. This relief may be carried back for offset against Lloyd's income in earlier years including the year of assessment in which death occurred subject to the three year rule. Any losses on underwriting accounts not closed at

the date of death and assessed on the Executors are relievable only against other Lloyd's related income and not against any other income assessable on the Executors as part of the Estate.

4. Syndicate capital appreciation

4.1 Basis of assessment

The syndicate capital gains for the account are also assessable in the tax year following the close of account - in effect

in the year of distribution.

For example, gains for the 1992 Account, which closes at 31 December 1994, are assessable for 1995/96.

4.2 The taxable amount

The capital gain or loss shown at Line 15 on the CSU taxation advice, which includes UK indexation relief, is assessable together with certain gains which are exempt from UK tax. These are shown on Line 11 of the form.

The capital gain or loss is therefore the sum of Lines 11 and 15. Please note that indexation relief is not available for the

UK exempt gains as the Irish Revenue take the view that the assets have been held for less than twelve months.

Where there are overall gains, after taking the above factors into consideration, then these gains will be assessable to Irish tax. Where there is an overall capital loss, then that loss will be available for offset against any personal gains in Ireland in the normal way subject to the normal reliefs and exemptions.

4.3 Foreign tax credits

UK capital gains tax will have been deducted from any syndicate capital gains. Such capital gains tax is calculated on a syndicate-by-syndicate basis and withheld as appropriate by the Managing Agents. It is not computed with reference to the overall position. Some of this tax will be refunded to Irish Names by the Inland Revenue after taking account of exemptions. However, the unrefundable portion will be available for credit.

In addition, US and Canadian taxes might be attributable to syndicate capital appreciation. The figure for US and Canadian tax relating to capital gains is shown on the double taxation relief report produced by the CSU.

Where credit relief has been claimed for any foreign taxes which are subsequently refunded then an appropriate adjustment to the original claim will need to be made. Credit relief for foreign taxes should be restricted to take account of any anticipated refunds of foreign taxes. The expression of doubt provisions of Section 14(4), Finance Act, 1988, can be applied where the circumstances permit. Where credit is available for foreign tax in computing Irish capital gains tax the relief is subject to the usual limits/rules.

4.4 Preliminary Capital Gains Tax Payments

A Name's share of syndicate capital gains or losses should be taken into account in computing the preliminary capital gains taxation payment. If the CSU taxation advice is not available when the payment is due, the capital appreciation figure shown on the consolidated personal statement can be used instead.

4.5 Capital Losses

Any capital losses as computed for UK tax purposes and shown on the CSU taxation advice will also be available for Irish tax purposes in accordance with the normal rules.

4.6 Rate of Capital Gains Tax

The rate of capital gains tax applicable is that relevant to assets held for more than one year but less than three years. The rate from 1988/89 to 1991/92 was 50%. Since 1992/93 the rate has been 40%.

4.7 Deceased Names

A deceased Name would be taxed on his/her capital gains in the year of assessment in which death occurs following the normal rules outlined at Paragraph 4.1. Thus, a Name dying in January 1995 will be assessable for 1994/95 on the syndicate capital gains of the 1991 underwriting account. However, as noted under Paragraph 3.12 above, certain underwriting accounts will not be closed at the time of death, and therefore syndicate capital appreciation will remain to be established.

These latter gains will be assessed on the Executor for each of the subsequent years of assessment, along the lines of the income tax treatment for underwriting profits or losses in this situation. Where the deceased Name has capital losses carried forward as at the date of death, these may be carried forward to his/her Executors for offset against any subsequent syndicate capital gains assessable in their name (but not against any other capital gains assessable on the Executors). The Executors will also be permitted to carry back capital losses arising in the final year of assessment of Lloyd's income and gains for offset against earlier years, including the year of assessment in which death occurred, subject to the normal three year rule. The capital gains tax personal exemption is not available in respect of assessments relating to the post-death period.

5. Funds at Lloyd's

5.1 Income

Names may also have a Personal Reserve Fund in addition to their Lloyd's Deposit. Any income and capital gains arising from assets held in these funds will not be shown on the CSU taxation advice. The income arising from these investments is treated for Irish tax purposes as part of the underwriting result - consistent with the treatment in the UK - and should be included in the Names' annual tax returns. This income is therefore taxable under the normal principles and the three year accounting period does not apply.

5.2 Capital gains

Any capital gains arising to a Name on disposals of any investments held in the Funds at Lloyd's are subject to Irish capital gains tax in accordance with the normal rules. These gains are not disclosed on the CSU taxation advice, but must nevertheless be included in the Names annual tax returns.

6. Impact for Irish Taxation of the Changes contained in the 1993 UK Finance Act

The UK's 1993 Finance Act introduces a number of changes to the basis upon which Lloyd's income is taxed in the UK. The changes are broadly tax neutral. Principal among them is the taxation as business income of capital appreciation on invested premiums (formerly taxed under the Capital Gains Tax rules) and the introduction of a new reserving arrangement, the New Special Reserve Fund, with contributions to the reserve qualifying as a business expense. The New Special Reserve Fund reflects the acceptance by the UK tax authorities of the special nature of Lloyd's business, the length of the business cycle and the inherent volatility of the results.

Capital appreciation on invested premiums will cease to be taxed under the Irish Capital Gains Tax rules from 1 January, 1994 and the treatment in Ireland of the New Special Reserve Fund will follow that adopted in the UK from the Lloyd's 1992 Year of Account. However, the 1992 and 1993 Accounts assessable for 1995/96 and 1996/97 will include gains arising before 1 January, 1994 and these gains are subject to capital gains tax.