

FROM: Head of Taxation EXTN: 5228
DATE: 9 December 2004 REF: Y3449
SUBJECT: **Corporate Members: Tax Treatment of Syndicate Capacity and IAS**

SUBJECT AREA(S): Tax Treatment of Syndicate Capacity

ATTACHMENTS: None

ACTION POINTS: **For Information**

DEADLINE(S): 31 December 2004 for making 4% election in some cases

1. Summary

1.1 This bulletin concerns the tax treatment of syndicate capacity under International Accounting Standards (IAS). It may be relevant to corporate members' decisions whether to prepare their statutory accounts under UK GAAP or IAS.

1.2 In particular, the bulletin

- draws members' attention to the deadline for making elections for 4% fixed rate writing down allowances for tax purposes (whether or not IAS is adopted); and

- summarises some helpful changes to the UK tax rules that were announced with the Pre-Budget Report on 2 December 2004.

2. Introduction

2.1 The UK corporation tax rules in Schedule 29 of Finance Act 2002 provide that the tax treatment of syndicate capacity generally follows the accounting treatment. Under these rules corporate members have since 2002 been able to claim tax relief on amortisation that is charged in their statutory accounts. Alternatively, a company can instead elect for a 4% straight line tax deduction irrespective of the amortisation that is shown in its accounts. For these purposes the capacity in each syndicate is considered separately.

2.2 A number of issues have arisen from the prospective adoption of IAS, either at company level or at consolidated group level. The underlying cause is that while under UK GAAP syndicate capacity is amortised over its useful economic life, which is assumed not to exceed 20 years, auditors may well take the view that under IAS it is to be treated as an indefinite life asset. If that is the case, capacity will not be written down in the corporate member's accounts under IAS unless an impairment charge is required, and as a result no tax deduction will be available except in the cases of impairment or realisation at a loss.

2.3 This bulletin therefore draws attention to the two-year time limit for making an election for a 4% fixed rate tax writing down allowance as an alternative to following the accounts charge for amortisation. Corporate members, particularly those which are considering adopting IAS from 1 January 2005 or in the future, should consider whether to take advice on this issue, and in particular on whether to make an election by 31 December 2004. It should also be borne in mind that it is the intention for UK GAAP to converge with IAS.

2.4 The bulletin also covers two proposed changes to the UK tax rules that were announced with the Pre-Budget Report. The first corrects an anomaly in the transitional rules on first adopting IAS, and the second ensures that the UK GAAP treatment is followed in the situation where the consolidated group accounts are under IAS but the corporate member prepares its own statutory accounts under UK GAAP.

3. Elections for 4% fixed rate writing down allowance

3.1 Under paragraph 10 of Schedule 29 FA 2002 a company can elect to write down the cost of an intangible fixed asset at a fixed rate of 4% of that cost, irrespective of the actual amortisation shown in its accounts. An election, which is irrevocable, must be made in writing to the Inland Revenue no later than 2 years from the end of the accounting period in which the asset is created or acquired. As noted above, capacity in each syndicate needs to be considered separately.

3.2 A member can therefore make an election to write down the cost of capacity at 4% for tax purposes, whether it prepares its accounts under IAS or UK GAAP. Under the time limit in paragraph 10 a member with a 31 December accounting date would have to make such an election by 31 December 2004 for an asset first acquired during 2002.

3.3 Once an election has been made in respect of capacity in a particular syndicate that election is also effective for any future additions to the capacity in the same syndicate. Likewise, if a 4% election is not made within 2 years of the end of the accounting period in which the capacity is first acquired, it will not normally be possible to make any future elections in respect of any later additions to it.

3.4 There are, though, some special provisions in respect of assets first acquired before 1 April 2002, which was the commencement date for the corporation tax regime. Syndicate capacity is unusual in being one of only two types of asset where pre-1 April 2002 assets come within the new regime. Although we have pointed out to the Inland Revenue that the general time limit in paragraph 10 may already have passed for pre-1 April 2002 assets, it has not agreed as a general matter to extend this limit to allow a later election for such assets.

3.5 All corporate members (whether currently considering adopting IAS or not) may therefore wish to consider now, and take advice from their advisors as appropriate, whether they wish to make a 4% election before 31 December 2004, either in relation to capacity acquired in 2002 or previously. In respect of the latter, the advisors should also be able to advise on the possibility and appropriateness of making claims after the normal two-year period.

4. Amendments to tax rules proposed in the Pre-Budget Report

Possible tax adjustment on first time adoption of IAS

- 4.1 The current rule (in paragraph 116A of Schedule 29) for the tax adjustment on first time adoption of IAS can give a perverse and unfair result if there is an upwards restatement in the carrying value of syndicate capacity that was held prior to 1 January 2002. In such circumstances the current clawback provision in paragraph 116A could result in a taxable amount greater than the tax deductions previously given.
- 4.2 We have pointed this out to the Inland Revenue, and as a result the Pre-Budget Report materials released on 2 December 2004 contain draft legislation aimed at remedying this anomaly. The Inland Revenue has told us that it intends to work with us to ensure that this legislation has the desired effect.

Company accounts under UK GAAP but consolidated accounts under IAS

- 4.3 The current rules (in paragraphs 5 and 6 of Schedule 29) provide that in certain circumstances the Inland Revenue can make reference to the useful life and the economic value of an asset as reflected in the consolidated group accounts in determining whether to allow tax deductions based on the accounts of a company. Under these rules, reference could be made to consolidated IAS accounts (in which capacity may not be amortised) in determining whether to allow a deduction for amortisation based on a company's UK GAAP accounts.
- 4.4 We also raised this issue with the Inland Revenue. We are pleased that the draft legislation released with the Pre-Budget Report also includes a proposed amendment to existing legislation which will prevent such reference being made where consolidated accounts are drawn up under IAS but a company draws up its accounts under UK GAAP. This means that, if a corporate member continues to account under UK GAAP the Inland Revenue would not be able to look at the treatment in consolidated IAS accounts to deny a tax deduction for amortisation shown in the UK GAAP accounts.

5. Distribution and contacts

- 5.1 This bulletin is being sent to underwriting agents, recognised auditors and direct corporate members. If you have any queries please contact:

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