

FROM: Head of Taxation
LOCATION: 86/441
EXTENSION: 5228
DATE: 14 October 2003
REFERENCE: TAX/DHC/Y3161
SUBJECT: **INHERITANCE TAX: NAMECOS AND FUNDS AT LLOYD'S**
ATTACHMENT: Annex
ACTION POINTS: To note
DEADLINE: Effective immediately

1. Introduction

1.1 Market bulletin Y2840 of 23 July 2002 dealt with the inheritance tax treatment of Funds At Lloyd's that are provided by the owner of the NameCo or take the form of a bank guarantee secured on the owner's personal assets. This bulletin provides further information about such assets (here called "third party FAL assets") and also about interavailable FAL.

2. Developments since 2002

2.1 The bulletin of 23 July 2002 reported that IHT business property relief is not due on third party FAL assets. This was a change from a previous understanding of the position. The bulletin also reported that the Inland Revenue believed that individuals could no longer rely on any incorrect assurances they may previously have been given but, if they wished, should take whatever steps were necessary to adjust their affairs.

2.2 Since then we have been asking the Inland Revenue to allow members who converted before July 2002 to continue to benefit from business property relief. In this regard we have pointed out that an individual who chooses to transfer assets into a NameCo to improve the IHT position would be exposed to a potential CGT charge on that transfer. We have also stressed the need for individuals who are affected by the earlier change of view to have more certainty over the current tax position.

2.3 Having considered the matter in detail, the Inland Revenue has now agreed that

individuals who have converted to underwriting through a NameCo can, within certain limits, have business property relief on the value represented by third party FAL assets up to and including 31 December 2004. The position will be reviewed during 2004 in the light of any changes that may be made to the current tax rules concerning the transfer of assets into a NameCo.

- 2.4 The Inland Revenue has also said that, from 1 January 2005 onwards, it will allow business property relief on the value represented by interavailable FAL only by reference to the individual member's own underwriting. Interavailable FAL will therefore qualify for business property relief only to the extent that it is proportionate to the member's unlimited liability underwriting. This is on the basis that the same principles apply for interavailable FAL as for third party FAL.
- 2.5 This is a change from the position that was previously reported in the market bulletin of 23 July 2002. However, subject to certain limits, full business property relief will be given on interavailable FAL assets up to and including 31 December 2004. This position will also be reviewed during the course of 2004.
- 2.6 The Annex to this bulletin contains a letter from the Inland Revenue setting out these points in detail. A summary is given below.

3. *Summary of IHT treatment*

3.1 *Deaths on or before 31 December 2004*

(a) Third party FAL (including assets backing a bank guarantee)

For deaths on or before 31 December 2004, business property relief will continue to be given on third party FAL assets, including amounts guaranteed under bank guarantees. However, the relief will be capped at the level of FAL needed for 2002 and will also be subject to the overriding constraint that the funds eligible for relief cannot be disproportionate to the level of underwriting as a whole.

(b) Interavailable FAL

For deaths on or before 31 December 2004, full business property relief will be given on interavailable FAL up to the level needed for 2003.

3.2 *Deaths on or after 1 January 2005*

Subject to the review of the position during 2004, the Inland Revenue will deal with deaths after the end of 2004 as follows.

(a) Third party FAL (including assets backing a bank guarantee)

As set out in the bulletin of 23 July 2002, no business property relief will be given, but the valuation of the assets for IHT purposes must take into account the negative value of the FAL arrangement to the estate.

(b) Interavailable FAL

Business property relief will be given on interavailable FAL assets, including amounts guaranteed under bank guarantees, to the extent that the interavailable FAL is not disproportionate to the individual's unlimited liability underwriting.

To the extent that business property relief is not given (for example, if the FAL is technically interavailable but there is no exposure to unlimited liability underwriting), the valuation of the assets for IHT purposes must take into account the negative value of the FAL arrangement to the estate.

3.3 The market bulletin of 23 July 2002 noted that relevant factors in calculating the negative value of the FAL arrangement to an individual's estate include valuing the open years and the likelihood that the assets will be drawn upon; and discounting the value of the assets to take account of the period for which they are fettered by the FAL arrangements. We apologise that we have not yet published these examples, but will do so shortly.

3.4 *Shareholdings in NameCos*

As noted earlier, shareholdings in unquoted companies currently qualify for 100% business property relief. A shareholder in a NameCo can therefore effectively get relief on the value of assets that are held within the NameCo to support its underwriting. We are discussing with the Inland Revenue whether the potential CGT charge on the transfer of FAL assets into a NameCo could be mitigated in future, although, as noted in the Inland Revenue's letter, they can give no commitment as to how these discussions may turn out.

4. *Readership and contact details*

4.1 This bulletin is being sent to underwriting agents, recognised auditors, personal accountants and members who deal with their own tax affairs. If, in the meantime, you have any queries, please contact Richard Pester on 020 7327 6727 or myself on 020 7327 5228.

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Date 10 October 2003
Your Ref TAX/DC/1n/Y2840

Dear David,

INHERITANCE TAX (IHT): NAMECOS

BUSINESS RELIEF FOR INTERAVAILABLE FUNDS

I said that I would write to you following our discussions about what might be done to resolve the concerns of some members who have converted their underwriting business into the hands of namecos.

To recap briefly, my colleagues at our Shares Valuation Division agreed some years ago, in response to a general enquiry, that IHT business relief would continue to be available for "interavailable" and "third party" funds made available by the name (assuming other requirements were satisfied) notwithstanding that the name's former personal underwriting business was being carried on by a corporate vehicle. The gist of this was passed on (so far as I am aware without attribution, and without further reference to us) in material soliciting names to convert their business to "nameco" form, and in newsletters to names who had made such a conversion. The inference is that some names have relied on this in deciding on a conversion backed by interavailable funds, and/or third party funds. And both those names and others may have placed some reliance on the point when adding to these funds or passing up opportunities to reduce them.

Information is available in large print, audio tape and Braille formats.
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Director: Gabs Makhoulouf



We are now clear that this view was wrong, and that relief is not strictly due on third party funds backing Lloyd's business carried on by a corporate name.

We have considered very carefully how far, if at all, the Revenue should regard ourselves as bound by the views previously expressed. As you know, past litigation on this issue gives clear guidance on the principles which apply: in particular, that anyone seeking a binding ruling should be quite clear about the purposes for which the ruling is sought, including the audience it is intended for and the reliance which will be placed on it. We are satisfied that the circumstances we are concerned with here do not meet that standard. And even if some names did commit interavailable funds on the basis of favourable reports passed on to them about the IHT position, it is clear from the timing of events that this was not so for all of the nameco names, or necessarily so for all the funds committed by any particular name.

In all these circumstances, we cannot hold out open-ended relief for third party funds on a basis which we think is not strictly due. But we understand the concerns of the names involved about where they now find themselves, and the risk of an unexpected IHT bill before they have been able to adapt their arrangements (if they wish to) to the true situation. So we are ready in the interests of an orderly adjustment to give a breathing space before all relief for third party funds is restricted by reference to the level (if any) of personal business. And we are ready to do so without disproportionate enquiry into the history of the particular funds in question and the extent of any reliance on IHT representations.

More specifically, we are ready to allow full relief for a name's third party funds, up to the amount needed for the level of underwriting in 2002 underwriting year, in the case of deaths before the end of 2004. This is subject, obviously, to the overriding constraint that the funds eligible for relief cannot be disproportionate to the level of the name's Lloyd's business as a whole (and in the case of assets backing a guarantee cannot exceed the amount guaranteed).

In working on this issue, and seeking a fuller understanding of the options facing nameco names, we have also looked in more detail at the role of interavailable funds, their relationship with third-party funds, and the implications of that for their IHT treatment. As I understand it, funds which are interavailable will remain so (unless the member is able to withdraw them), even though the personal business of the name in question has fallen away and ultimately come to an end. They would fulfil the same function as third party funds at that stage, but would retain a distinct status and could retain it indefinitely even when all activity lies in the nameco. (I believe that Lloyd's rules do not currently permit a straightforward conversion of interavailable funds into third party funds even if the member is no longer exposed to personal business.)

In these circumstances, we would not want anything we have said about IHT relief for interavailable funds to be taken as guaranteeing permanent entitlement to full relief irrespective of the mix of underlying business.

It has long been our view, as you know, that FAL is not eligible for relief where it is out of proportion to the underwriting activity carried on by the name and we think that in strictness that principle must apply to deny relief for interavailable FAL which is referable to business carried on by the nameco rather than by the name himself.

And we think this is so notwithstanding that the total FAL may be no greater than is needed to back the name and nameco business in aggregate.

That said, we accept, as we have for third party FAL, that there is a case for transitional arrangements so that nameco names can adjust in an orderly way to what we believe is the proper long-term treatment of interavailable funds. We are ready to take essentially the same approach as I have described for third party funds: i.e. that we will allow full relief for interavailable funds, up to the level needed for the 2003 underwriting year, in the case of deaths before the end of 2004.

That would not protect anything added to interavailable funds to increase them beyond their level for the present underwriting year, and would be subject, as before, to total FAL eligible for relief not being out of proportion to the total Lloyd's business. After the end of 2004, we would allow only the amount we believe to be strictly due by reference to the name's remaining personal business, if any.

In addressing these issues, finally, we have been conscious that there are other open issues in the taxation of Lloyd's business which are potentially relevant to the options which nameco names may want to consider when planning for their IHT position. In particular we are looking with you at the CGT position of assets introduced into corporate names, which may be relevant if names are considering replacing interavailable funds by funds held by the nameco itself. We have named end-2004 as the terminal date for the practices just described in the expectation that these open issues will have been resolved, one way or another, in good time for nameco names to implement any new arrangements they wish to make to fund their Lloyd's activity. As we have discussed, we cannot give you any sort of commitment about how this other work will turn out: but we have said that we would be ready to review the IHT situation with you, in the light of events, around the middle of next year.

I hope this is helpful: please get in touch again if there is any point you would like me to try to clarify.

Yours sincerely,

Martyn Haigh
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Capital Taxes Policy Group