Market Bulletin

LLOYD'S

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FROM:	Juliet Phillips, Tax Manager
LOCATION:	TAX/G4/441
EXTENSION:	6839
DATE:	15 December 2003
REFERENCE:	TAX/JP/Y3211
SUBJECT:	**US TAXATION: ELECTION TO STAY WITHIN OLD US-UK DOUBLE TAXATION TREATY**
ATTACHMENTS:	Annex
ACTION POINTS:	UK resident members to notify MSU if they do **not** wish to elect to remain within the "old treaty" for 2004.
DEADLINE:	**30 January 2004**

1. Introduction

1.1 On 31 March 2003 a new double taxation treaty ("the new treaty") was ratified between the US and the UK. This provides rules governing the taxation of UK resident taxpayers, including UK resident members of Lloyd's, on their US business.

1.2 For UK resident Lloyd's members the new treaty entered into force for withholding taxes on interest and dividends on 1 May 2003 and enters into force for all other US taxes, including Federal Excise Tax on insurance premiums, on 1 January 2004. However, taxpayers can elect to defer its application for one year.

1.3 It is likely that, all other things being equal, Lloyd's members will benefit from delaying the application of the new treaty by one year. It is intended that an election will be made to extend the application of the previous double taxation treaty between the US and the UK ("the old treaty") by one year for all members, unless the member notifies us otherwise. This will be done under the powers of attorney to deal with US tax matters.

1.4 Any members who do **not** wish to elect to extend the application of the old treaty for a year should inform Lloyd's MSU in writing of their decision not to do so by 30 January 2004.

2. Election to remain within the "old treaty" for a further year

2.1 Unless an election is made to extend the application of the old treaty, the new treaty is effective for withholding taxes on interest and dividends paid from the US from 1 May 2003. For all other US taxes within its scope it is effective for tax periods beginning on or after 1 January 2004 unless an election is made. However, it is important to note that if an election is made it is effective for all purposes and all sources of US income. It is not possible to pick and choose so that an extension is made for some purposes or some taxes only.

2.2 As corporate members of Lloyd's only carry out their Lloyd's business and matters ancillary to it, they are unlikely to be able to benefit from the new treaty provision giving a zero withholding tax rate on dividends received from US subsidiaries. On the other hand, a number of provisions in the new treaty (see Annex to this bulletin) could put them in a worse position if they do not elect to extend the old treaty for a year.

2.3 In general, an election to extend the old treaty for a year is therefore likely to be either beneficial or neutral for corporate members. However, members should take whatever advice they need on their own circumstances before deciding whether they wish to be covered by such an election or whether they want to opt out of it.

2.4 The same is also generally true for individual members who are tax resident in the UK and who do not have other economic interests in or connection with the US. As a general matter, electing to remain within the old treaty for a year is likely to be either beneficial or neutral in respect of their Lloyd's business. Members with other connections with the US or with other particular circumstances may, however, be able to benefit from other provisions in the new treaty, for example on pensions. If so, and if the benefits outweigh any disadvantage in respect to their Lloyd's business, such members may wish to be covered by the new treaty at an earlier date.

2.5 Individuals should take whatever advice they need from their personal advisers on their own circumstances before deciding whether they wish to be covered by a general election or to opt out of it.

2.6 Similar concerns apply to Scottish Limited Partnerships (SLPs). An SLP is treated as a taxable entity for US tax purposes but is fiscally transparent for UK tax purposes (i.e. US tax is levied on the SLP but UK tax is levied on the partners). An SLP that wishes to opt out of the extension of the old treaty in respect of any or all of its partners should itself send the notification to Lloyd's MSU together with details of the names and addresses of all its partners. If the opt out is in respect of some partners only, the details should include each partner's percentage share of the SLP's income.

2.7 The Annex to this bulletin contains a brief summary of the provisions of the new treaty that will, all other things being equal, make it in general either beneficial or neutral for a member to elect to extend the old treaty for a year. This should, however, be taken only as a general overview and should not be taken as replacing any specific advice that a member may take.

3. Making the election

3.1 Lloyd's will arrange, through the power of attorney to deal with US tax matters, for an election to be made to extend the provisions of the old treaty for a further year for all UK tax resident members covered by the single US tax return unless a signed notification is delivered to Lloyd's MSU specifying that the member does **not** wish to make this election.

3.2 Signed notifications to opt out of the election should be sent **by 30 January 2004** to:

Christine Allcott
Manager, Lloyd's Tax Operations
Gun Wharf
Dock Road
Chatham
Kent ME4 4TU

4. Readership and contact details

4.1 This bulletin is being sent to all underwriting agents, direct corporate members, recognised auditors, accountants and members who deal with their own tax affairs.

4.2 If you have any queries on the details of the new treaty, please contact:

Juliet Phillips tel: 020 7327 6839 email: juliet.phillips@lloyds.com ; or
David Clissitt tel: 020 7327 5228 email: david.clissitt@lloyds.com .

For any queries on the notification process to opt out of the election, please contact:

Christine Allcott tel: 01634 392433 email: christine.a.allcott@lloyds.com .

Juliet Phillips
Tax Manager

ANNEX

OUTLINE OF TREATY PROVISIONS LIKELY TO AFFECT LLOYD'S MEMBERS

1. The new Treaty has made some significant changes to the way in which UK residents are taxed in respect of their US interests. Below is a summary of the main changes that will affect Lloyd's members in relation to their Lloyd's US business. In addition to the limitations on access to treaty benefits, the provisions that may particularly affect members are those on Branch Profits Tax and Federal Excise Tax.

Limitation on benefits

2. Although UK tax residence is a sufficient condition for individuals, UK resident companies do not automatically qualify for benefits under the new treaty. Corporate members will therefore have to demonstrate their eligibility for benefits under Article 23 of the new treaty. This can involve some complex tests for some companies. We will issue a further market bulletin on it in the New Year outlining the conditions and asking corporate members to show how they are eligible for the benefits.

3. It is not, however, necessary to demonstrate eligibility under the new treaty in order to make an election to extend the application of the old treaty. Eligibility under the old treaty is enough.

Profits of a Permanent Establishment

4. Under Article 7 of the new treaty, a UK resident that is eligible for treaty benefits will be taxed in the US on the profits arising from a US trade or business only if it is carried on through a permanent establishment in the US. This potentially reduces the US tax burden, as only those business profits that are attributable to the permanent establishment will be taxed in the US. The treaty definition of a permanent establishment is more restrictive than the US domestic legislation under which a foreign taxpayer is otherwise taxed on profits that are effectively connected to a US trade or business.

5. A UK company has to demonstrate its eligibility for benefits under the new treaty in order to benefit from the permanent establishment provision. Any UK resident company that qualifies for benefits under the old treaty but not under the new treaty would therefore potentially be in a better position under the old treaty.

Withholding Tax on dividends and interest

6. Under Articles 10 and 11 of the new treaty, UK residents can benefit from lower withholding tax rates on US source dividends and income than would be the case if they are not entitled to treaty benefits. This applies to non-effectively connected income, i.e. income that does not fall to be taxed as part of the profits of a US permanent establishment.

7. The normal US withholding tax rate on dividends is 30%, but under the new treaty this is reduced to 15% or 5%, or if certain further conditions are met nil. In practice the lowest rate available to Lloyd's members is likely to be 15%, which is the same as under the old treaty.

8. The normal US withholding tax rate on interest is also normally 30%, but under the new treaty this is reduced to nil, which is the same as under the old treaty.

Branch Profits Tax

9. US domestic legislation imposes a "branch profits tax" on a US branch of a foreign enterprise. This levies a further tax on the "dividend equivalent amount" of the US branch which is intended to replicate the tax that the US would have levied if the branch had been a subsidiary that had paid its repatriated profits by way of a dividend to a foreign parent.

10. The old treaty provided a total exemption from the branch profits tax. However, under Article 10(7) of the new treaty, a UK resident company that qualifies for the benefits of the treaty will only automatically get a reduction in the rate of branch profits tax to 5% (from the domestic rate of 30%). The nil rate, or exemption from branch profits tax, is available only to individuals and to those UK companies that qualify for treaty benefits in certain ways or were trading before October 1998. Further details will be included in the market bulletin to be issued on the limitation on benefits in the New Year.

11. Any corporate members that do not qualify for treaty benefits would be exposed to a 30% branch profits tax under the new treaty compared to zero under the old treaty. Corporate members that only qualify for benefits under certain criteria and do not meet the pre-October 1998 trading condition would be exposed to a 5% branch profits tax, compared to zero under the old treaty.

Federal Excise Tax

12. US domestic legislation imposes a Federal Excise Tax (FET) on insurance and reinsurance premiums that are paid by a person in the US to a foreign insurer in respect of US risks, unless the premiums form part of the taxable income of a US branch of that insurer. This therefore applies to the non-effectively connected income of the foreign insurer.

13. The old treaty provided an unqualified exemption from FET for the non-effectively connected insurance and reinsurance premiums paid to a UK resident insurer.

14. Article 7(5) of the new treaty provides only a qualified exemption for UK insurers. Premiums received from the US are exempt from FET unless they fall foul of an anti-avoidance provision called a "conduit arrangement". A conduit arrangement is a transaction or series of transactions under which all or substantially all of the income is paid to a non-UK and non-US resident that would not have got the FET exemption if the premium had been paid direct to it from the US, in circumstances where a main purpose of the arrangement is to get the FET benefit.