

MARKET BULLETIN

REF: Y4028

Title	US Federal Excise Tax on Outwards Reinsurance
Purpose	For Managing Agents <ol style="list-style-type: none">1. to note a change to Lloyd's Outwards Reinsurance Scheme and to draw their attention to a need to review the data input in order to avoid overpaying US Federal Excise Tax.2. to remind them of the need to enter a 'P' indicator to indicate that the premium is to be 'paid this time'.
Type	
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Deadline	Effective from 13 August 2007
Related links	

1 Introduction

Managing agents are asked to note that a change will be made to the Lloyd's Outwards Reinsurance Scheme (LORS) from 13 August 2007. Each year the US Internal Revenue Service (IRS) audits the calculation of the US federal excise tax (FET) liability of Lloyd's members and syndicates. Historically, there have been significant errors in the data entered on LORS which has resulted in the IRS assessing significant FET audit adjustments. The change to the coding of these premiums discussed herein, are being implemented in an effort to reduce the FET audit adjustment exposure, including the imposition of interest and penalties. Although alternative solutions were considered this was the only option acceptable to all parties.

Managing agents should understand that failure to apply a LORS code to a premium will now result in the premium being coded as unprotected and, therefore, potentially subject to FET. It is possible that as a result of this change to LORS syndicates will pay FET on premiums that in fact are paid to protected companies which should not be subject to the FET. The onus will be on the managing agents to ensure that premiums are properly coded

to avoid overpayment of the FET by reviewing LORS on a timely basis to ensure that accurate information has been included on processing. Further information to assist managing agents with their review is given below.

2 Understanding the errors

FET is payable at 1% on certain outward reinsurance premiums paid by Lloyd's syndicates to unprotected companies. For this purpose, unprotected companies are non-US reinsurers that are not entitled to an exemption from FET under a Double Taxation Treaty between their country of residence and the United States. Under the 2005 FET Closing Agreement and related Agreement of Understanding, the FET on outward reinsurance premiums applies to premiums paid in US dollars and is calculated by reference to the proportion of the syndicate's US dollar business that is US situs.

When a premium is processed through LORS the broker may insert a unique LORS code that identifies the reinsurer(s). The broker then allocates the percentage of the premium that is payable to unprotected companies and Lloyd's syndicates. It is currently not mandatory to insert a LORS code and the LORS codes and the percentage allocations are not linked, so there are often discrepancies between the codes and the allocations of the premium.

3 The current position

Lloyd's files an aggregate FET return for all syndicates on a quarterly basis and the LORS system is used to determine which reinsurance premiums have been paid to unprotected companies. If there is insufficient data within LORS regarding the status of the reinsurer, the current default is to treat the premium as being paid to a *protected* reinsurer with the result that no FET is paid with respect to that premium.

The IRS audit the FET returns prepared by Lloyd's each year and spend a significant amount of time checking that FET has been paid on all US dollar reinsurance premiums covering US situs risks that are paid to unprotected companies. If no LORS code is entered, and no reinsurer is listed, the IRS are unable to verify whether the reinsurer is exempt from FET and, therefore, one strand of the audit work which is currently carried out is to ask the brokers for more information so that Lloyd's is able to provide verification for the FET treatment to the IRS. If the name of the reinsurer is not obtained, the IRS assumes that the premium is being paid to an unprotected company. This results in a significant audit adjustment each year and unless steps are taken to correct these errors, substantial penalties may be payable in the future.

4 Position from 13 August 2007

From 13 August 2007 the system will be automated so that if LORS codes have been added the amount of premium payable to unprotected companies is calculated. From the same date, if no LORS code has been entered, rather than assuming that the premium has been paid to a protected company as currently, the LORS system will assume that the premium has been paid to an *unprotected* company. In this case, if the company is in fact

protected, the default to unprotected status will result in an overpayment of FET unless action is taken by the managing agents to ensure that accurate LORS codes are included for every reinsurance premium payment.

It is important to note that the IRS is not likely to propose an audit adjustment to cure FET overpayments. Although Lloyd's may file amended FET returns, the cost of refiling will be borne by the managing agents consistent with a user pays basis. Therefore, the most efficient way of ensuring that FET is not overpaid is to ensure that the LORS coding is reviewed before the reinsurance premium payment is processed.

5 Steps that Managing Agents need to take in order to ensure FET is not over paid.

Managing agents have up to five working days after the broker enters the information on LORS to identify overpaid FET on LORS transactions and liaise with or instruct the broker to improve reinsuring market data on such items before the transactions are processed. Therefore, managing agents should check that a LORS code has been entered in respect of each reinsurer and request that the broker updates LORS where codes are missing.

Further information about this process may be found in the LORS manual.

6 The 'P' Indicator

Managing Agents are reminded that when checking LORS they should ensure that a 'P' indicator is shown to indicate that the reinsurance premium is to be 'paid this time'. Again, further information can be found in the LORS manual.

7 Contact

Any queries relating to the content of 1-4 or 6 above should be addressed to Peter Walk (telephone: 0207 327 5477, email: peter.walk@lloyds.com) or Juliet Phillips (telephone 0207 327 6839, email: juliet.phillips@lloyds.com). Any queries relating to section 5 above should be addressed to the Exchanging Customer and User Support Team (telephone: 01634 887717).

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