LLOYD'S

MARKET BULLETIN

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Title	Tax Treatment of Foreign Exchange for Members' UK tax purposes (and the avoidance of double counting)
Purpose	To notify the Market of HMRC's view on the above
Type	Information
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Date	20 November 2009
Deadline	
Related links	

Background

Following the large fluctuations in the UK£:US$ exchange rate during 2008, many members and managing agents have asked for clarity of the tax treatment of certain foreign exchange rate adjustments. We apologise for the delay in the release of this Bulletin but this issue is extremely complex and has taken a significant amount of time to resolve.

During the course of our review it became clear that there have been differences in approach and confusion around the rules. We have discussed these issues with HMRC who have provided us with their view of the tax treatment. This is set out in the attached Appendices. Appendix 1 sets out the position as applicable to individual members and Appendix 2 sets out the position as applicable to corporate members.

We are also taking this opportunity to set out a more detailed explanation of some other exchange rate adjustments that are made for accounting purposes and HMRC's view of the tax treatment, as this is not always apparent on the face of the CTA1 and CTA2. HMRC are aware that there has not always been consistency of treatment in this area in the past but they do expect all members to follow the guidance set out below in their 2008 and all future tax returns. Any member who thinks that the guidance causes them difficulty or disagrees with HMRC's view should discuss the matter with their Customer Relationship Manager ("CRM") or local tax office.

In order to understand the tax treatment of these items fully it is first necessary to understand the accounting treatment of foreign exchange adjustments in the syndicate accounts and this is set out in the Appendices.

If you have any questions on the content of this Market Bulletin, please contact Juliet Phillips (email: juliet.phillips@lloyds.com; telephone: 0207 327 6839) or Helen Harrison (email: helen.harrison@lloyds.com; telephone; 0207 327 6859)

Appendix 1

Individual members

Early US dollar profit releases

Summary of tax treatment

The foreign exchange gain recorded in the syndicate accounts for the 2006 year of account in respect of early profit releases, is in HMRC's view not taxable. Equally, the member will receive no relief for the foreign exchange loss arising to them in respect of the same. The foreign exchange gain recorded by the syndicate for accounting purposes is excluded from the CTA1 result, so provided members follow the CTA1 they will not be subject to tax on this gain. Members will however, need to ensure that the equal and opposite loss arising to them is also not included anywhere in their tax return (or included on any prior year tax return). Further detail on the accounting and tax treatment is provided below.

Accounting treatment

Where a syndicate makes an early release of profits in dollars, it books a prepayment in its accounts. This prepayment is revalued at the 36 month point when the syndicate year of account closes or goes into run-off.

The member technically owes an equal amount to the syndicate, since the year of account had not closed when the prepayment is made. An individual member will have incurred a profit or loss on exchange on the amount due to the syndicate even if no amount is recorded in a set of accounts.

For example, a member receives an early profit release of $1,000 in respect of the 2006 year of account in June 2008, when the exchange rate is £1:$1.9664. At 31 December 2008, when the Year of Account closed, the exchange rate was £1:$1.44. The syndicate accounts for the 2006 Year of Account will show a foreign exchange gain of £185.90 calculated as follows:

$1,000 prepayment translated into sterling at 1.9664	=	£508.54
$1,000 prepayment translated into sterling at 1.44	=	£694.44
Exchange gain	=	£185.90

Individual members will not record this loss anywhere but a loss of £185.90 on the amount they owe to the syndicate due to the year of account not being closed when the payment was made could still be said to have been "incurred".

$1,000 due to syndicate translated into sterling at 1.9664	=	£508.54
$1,000 due to syndicate translated into sterling at 1.44	=	£694.44
Exchange loss	=	£185.90

<u>Tax treatment</u>

It is HMRC's view that the syndicate foreign exchange gain on the early profit release of £185.90 is not taxable and the member's foreign exchange loss on the early profit release of £185.90 is not deductible (or relievable as a capital loss). The two amounts in effect net off to give a net nil position. The mechanics of how this is achieved is set out below and is intended to ensure that no timing difference is created due to the fact that the distributions basis is used to tax syndicate items but member level items are normally taxed on an annual basis.

Syndicates are required to treat the foreign exchange gain arising on the early profit release as non taxable in the syndicate tax return. This is then reflected on the CTA1 for the 2006 YOA provided to members by Market Services.

Members need make no adjustment in their member level tax return to remove the foreign exchange gain of £185.90 as this is already adjusted on the CTA1.

The member must then consider whether it is necessary to make an adjustment in their tax return in respect of foreign exchange on the dollars received. If the member immediately sold the dollars upon receipt no further adjustment will be required. However, if the member held on to the dollars then it will be necessary to consider making an adjustment for an exchange difference at the end of the period.

For an individual member, the foreign exchange gain or loss arising on the disposal of foreign currency is subject to capital gains tax, and therefore a member who received an early profit release of $1,000 and sold those dollars on 31 December 2008 would need to report a capital gain of £185.90 in their 2008-09 tax return, reflecting the movement on exchange rate as used in the example above. But an individual member who still held the dollars on 31 December 2008 would make no adjustment for this amount until they eventually disposed of the dollars.

So, to summarise the position for individual members:

Tax return in which the adjustment will be recognised		
2006 YOA	Member's share of exchange gain recorded in syndicate accounts	£185.90
2009	Adjustment made on syndicate tax return/ CTA1	(£185.90)
2008	Net taxable exchange gain/(loss)	NIL

Note: This illustration assumes that dollars received in June 2008 were still held at 31 December 2008 and therefore no capital gain or loss has been reported.

Excess US dollar cash calls

Excess cash call here means an amount paid to the managing agent by the member which has not been applied against specific debts by the syndicate closing date.

Summary of tax treatment

The foreign exchange loss recorded in the syndicate accounts for the 2006 year of account in respect of excess US dollar cash calls, is in HMRC's view not deductible for tax purposes. Equally the member will not be subject to tax on the foreign exchange gain arising to them in respect of the same in their 2008 annual accounts. This is achieved by making an adjustment to the member's tax return and, to aid members with this, the necessary adjustment is included on the CTA2. Therefore provided members follow the CTA2, the exchange loss shown in the syndicate accounts will not be treated as deductible. Further detail on the accounting and tax treatment is provided below.

Accounting treatment

Where a syndicate receives an excess US dollar cash call it books an amount "due to members" in its accounts. This debt is revalued at the 36 month point when the syndicate year of account closes or goes into run-off. The dollars held at the 36 month point will also be revalued and this will also be recorded in the syndicate accounts.

The member is technically owed an equal amount by the syndicate, since the amount paid was in excess of amounts that the syndicate actually required to meet expenses etc. An individual member will have incurred a profit or loss on exchange on the amount due back from the syndicate even if no amount is recorded in a set of accounts.

For example, a managing agent received an excess cash call from a member of $5,000 in March 2008, when the exchange rate was £1:$2.0020. At 31 December 2008, when the year of account closed, the exchange rate was £1:$1.44. The syndicate accounts for the 2006 Year of Account will show a foreign exchange loss of £974.72.

$5,000 due to member translated into sterling at 2.0020	=	£2,497.50
$5,000 due to member translated into sterling at 1.44	=	£3,472.22
Exchange loss	=	(£974.72)

Individual members will not record this gain anywhere but a gain of £974.72 on the amount owed from the syndicate due to excess cash calls could still be said to have been "incurred".

$5,000 due from syndicate translated into sterling at 2.0020	=	£2,497.50
$5,000 due from syndicate translated into sterling at 1.44	=	£3,472,22
Exchange gain	=	£974.72

<u>Tax Treatment</u>

It is HMRC's view that the syndicate foreign exchange loss on the excess US dollar cash call of £974.72 is not deductible for tax purposes and the member's gain on the excess US dollar cash call of £974.72 is not taxable. The two amounts in effect net off to give a net nil position. The mechanics of how this is achieved is set out below and is intended to ensure that no timing difference is created due to the fact that the distributions basis is used to tax syndicate items but member level items are normally taxed on an annual basis.

The member is not entitled to recognise this loss for tax purposes as it is matched by an equal and opposite profit as explained above i.e. the gain arising on the amount due to the member by the syndicate. However, this adjustment is not made in the CTA1. Instead a gain of £974.72 would be reported via the 2009 CTA2 and this should be included in the member's tax return for 2009-10. This has the effect of cancelling the loss recognised in the syndicate accounts.

Members should note that the amount shown on the CTA2 will be included within the foreign exchange adjustment on cash calls generally and will not be distinguished as an amount in relation to excess cash calls. However, if members adjust their tax returns in line with the CTA2, the effect will be that the loss on excess cash calls as shown on the syndicate tax return is cancelled out

So, to summarise the position for individual members:

Tax return in which the adjustment will be recognised		
2006 YOA	Member's share of exchange loss recorded in syndicate accounts	(£974.72)
2009	Adjustment in CTA2	£974.72
2009	Net taxable exchange gain/(loss)	NIL

You should note that the dollars held by the syndicate will also be revalued at the year end and a gain of £974.72 will be recorded in the syndicate accounts in respect of this cash held. It is this gain which is recognised for tax purposes and since this is included in the syndicate accounts it is included within the CTA1 result.

Exchange differences in relation to distributions received

Tax Treatment

A foreign exchange gain or loss will also arise in respect of US dollar profits between the date of closure of the year of account and the date the dollars are released by the syndicate to Market Services for distribution. Any foreign exchange gain or loss that a member suffers due to a fluctuation in the US $ exchange rate between the date that the year of account closes and the date that the amount is released to Market Services is taxable or allowable: but no adjustment is required to reflect this in the member's tax return as the amount is reported by the syndicate on the syndicate tax computation and so is included in the CTA1 result.

Accounting Treatment

The syndicate does not record in its accounts the foreign exchange gain or loss arising on US dollar profits due to a movement in exchange rate from the date of closure of the account until the date that the dollars are released to Market Services.

Tax Treatment

Syndicates are required to make an adjustment in the syndicate tax computation to include any foreign exchange gain or loss arising on US dollar profits from the date of closure of the year of account until the date that profits are released to Market Services.

For example, suppose a member is due a US dollar profit distribution of $20,000. At 31 December 2008, when the exchange rate was £1:$1.44, the amount due to the member as shown on the consolidated personal account was £13,888.89. However, when the amount is paid to Market Services in April 2009 the exchange rate is £1:$1.5217, so the sterling value of the distribution is £13,143.19 due to the movement in the US dollar exchange rate.

The syndicate is therefore required to report a foreign exchange loss of £745.70 on the syndicate tax return and this is then reflected in the CTA1 for the member.

The above example assumes that the member opts to receive the distribution in sterling. The same adjustment would however also apply if the member receives the distribution in dollars. In this latter case the exchange rate at the date that the dollars were released to Market Services is included on the CTA2 to enable the member to make any further foreign exchange adjustments.

Appendix 2

Corporate Members

Early US dollar profit releases

Summary of tax treatment

The foreign exchange gain recorded in the syndicate accounts for the 2006 year of account in respect of early profit releases, is in HMRC's view not taxable. Equally, the member will receive no relief for the foreign exchange loss arising to them in respect of the same. The foreign exchange gain recorded by the syndicate for accounting purposes is excluded from the CTA1 result, so provided members follow the CTA1 they will not be subject to tax on this gain. Members will however, need to ensure that the equal and opposite loss arising to them is also not included anywhere in their tax return (or included on any prior year tax return). Further detail on the accounting and tax treatment is provided below.

Accounting treatment

Where a syndicate makes an early release of profits in dollars, it books a prepayment in its accounts. This prepayment is revalued at the 36 month point when the syndicate year of account closes or goes into run-off.

The member technically owes an equal amount to the syndicate, since the year of account had not closed when the prepayment is made. Corporate members will therefore also record an amount due to the syndicate in their corporate member accounts and will revalue this amount at each year end until the year of account closes.

For example, a member receives an early profit release of $1,000 in respect of the 2006 year of account in June 2008, when the exchange rate is £1:$1.9664. At 31 December 2008, when the year of account closed, the exchange rate was £1:$1.44. The syndicate accounts for the 2006 Year of Account will show a foreign exchange gain of £185.90 calculated as follows:

$1,000 prepayment translated into sterling at 1.9664	=	£508.54
$1,000 prepayment translated into sterling at 1.44	=	£694.44
Exchange gain	=	£185.90

Corporate members will have recorded a loss of £185.90 in their member level annual accounts for 2008 (although this may have been recorded over a number of years on an annually accounted basis if the early profit release was paid earlier than 2008). Therefore, based on the facts as given above the corporate member would record a loss of £185.90 in their 2008 annual accounts.

$1,000 due to syndicate translated into sterling at 1.9664	=	£508.54
$1,000 due to syndicate translated into sterling at 1.44	=	£694.44
Exchange loss	=	£185.90

Tax treatment

It is HMRC's view that the syndicate foreign exchange gain on the early profit release of £185.90 is not taxable and the member's foreign exchange loss on the early profit release of £185.90 is not deductible (or relievable as a capital loss). The two amounts in effect net off to give a net nil position.   The mechanics of how this is achieved is set out below and is intended to ensure that no timing difference is created due to the fact that the distributions basis is used to tax syndicate items but member level items are normally taxed on an annual basis.

Syndicates are required to treat the foreign exchange gain arising on the early profit release as non taxable in the syndicate tax return. This is then reflected on the CTA1 for the 2006 YOA provided to members by Market Services.

Members need make no adjustment in their member level tax return to remove the foreign exchange gain of £185.90 as this is already adjusted on the CTA1. Normally, corporate members would follow their accounts for tax purposes but in this case, as the adjustment to cancel the gain has already been made on the CTA1, any loss shown in the member's 2008 accounts must be ignored by adding it back in the 2008 return. If the adjustment was not made on the CTA1 but instead members followed their accounts, a timing difference would arise between the recognition of the gain by the syndicate and the loss by the member (or vice versa in the event that the syndicate recognises a loss and the member a gain). This is because the gain recognised in the syndicates 2006 YOA results is taxable in 2009, but the loss recorded in the members 2008 annual accounts is deductible in 2008.

The member must then consider whether it is necessary to make an adjustment in their tax return in respect of foreign exchange on the dollars received. If the member immediately sold the dollars upon receipt no further adjustment will be required. However, if the member held on to the dollars then it will be necessary to consider making an adjustment for any exchange difference at the end of the period.

Corporate members who did not dispose of the dollars immediately upon receipt will need to record any gain or loss arising to the year end, and for this they simply follow the accounts.

Therefore, corporate members who continued to hold the dollars at the end of 2008 need to recognise the exchange gain that will have arisen from the date that the dollars were released until the end of 2008

So, to summarise the position for corporate members:

Tax return in which the adjustment will be recognised		
2006 YOA	Member's share of exchange gain recorded in syndicate accounts	£185.90
2009	Adjustment made on syndicate tax return/ CTA1	(£185.90)
		-
2008	Exchange loss on balance with syndicate as per member's annual accounts (See Note below)	(£185.90)
2008	Added back for tax purposes	£185.90
		-
2008	Member's exchange gain on dollars held as per their annual accounts (assuming the dollars are still held at 31 December 2008)	£185.90
2008	Net taxable exchange gain/(loss)	£185.90

Note: This illustration assumes that the early profit release was made in the year of closure i.e between 24 and 36 months of the year of account. If the early profit release was made earlier than this e.g at 18 months, the corporate member will have made an accounting entry to record the gain or loss in respect of the early profit release at 24 months and a further adjustment at 36 months. It is these entries which must be ignored for tax purposes.

Excess US dollar cash calls

Excess cash call here means an amount paid to the managing agent by the member which has not been applied against specific debts by the syndicate closing date.

Summary of tax treatment

The foreign exchange loss recorded in the syndicate accounts for the 2006 year of account in respect of excess US dollar cash calls, is in HMRC's view not deductible for tax purposes. Equally the member will not be subject to tax on the foreign exchange gain arising to them in respect of the same in their 2008 annual accounts. This is achieved by making an adjustment to the member's tax return and, to aid members with this, the necessary adjustment is included on the CTA2. Therefore

provided members follow the CTA2, the exchange loss shown in the syndicate accounts will not be treated as deductible. However, members will need to ensure that the equal and opposite gain arising to them is not included elsewhere in their tax return (or included in any prior year tax return). Further detail on the accounting and tax treatment is provided below.

<u>Accounting treatment</u>

Where a syndicate receives an excess US dollar cash call it books an amount "due to members" in its accounts. This debt is revalued at the 36 month point when the syndicate year of account closes or goes into run-off. The dollars held at the 36 month point will also be revalued and this will also be recorded in the syndicate accounts.

The member is technically owed an equal amount by the syndicate, since the amount paid was in excess of amounts that the syndicate actually required to meet expenses etc. Corporate members will therefore also record an amount due from the syndicate in its corporate member accounts and will revalue this amount at the each year end until the year of account closes.

For example, a managing agent received an excess cash call from a member of $5,000 in March 2008, when the exchange rate was £1:$2.0020. At 31 December 2008, when the year of account closed, the exchange rate was £1:$1.44. The syndicate accounts for the 2006 Year of Account will show a foreign exchange loss of £974.72.

$5,000 due to member translated into sterling at 2.0020	=	£2,497.50
$5,000 due to member translated into sterling at 1.44	=	£3,472.22
Exchange loss	=	(£974.72)

Corporate members will have recorded a gain of £974.72 in their 2008 annual accounts (Note: this may have been recorded over a number of years on an annually accounted basis if the cash call was paid earlier than 2008).

$5,000 due from syndicate translated into sterling at 2.0020	=	£2,497.50
$5,000 due from syndicate translated into sterling at 1.44	=	£3,472,22
Exchange gain	=	£974.72

Tax Treatment

It is HMRC's view that the syndicate foreign exchange loss on the excess US dollar cash call of £974.72 is not deductible for tax purposes and the member's gain on the excess US dollar cash call of £974.72 is not taxable. The two amounts in effect net off to give a net nil position. The mechanics of how this is achieved is set out below and is intended to ensure that no timing difference is created due to the fact that the distributions basis is used to tax syndicate items but member level items are normally taxed on an annual basis.

The member is not entitled to recognise this loss for tax purposes as it is matched by an equal and opposite profit as explained above i.e. the gain arising on the amount due to the member by the syndicate. However, this adjustment is not made in the CTA1. Instead a gain of £974.23 would be reported via the 2009 CTA2 and this should be included in the member's tax return for 2009. This has the effect of cancelling the loss recognised in the syndicate accounts.

Corporate members should also follow the CTA2 adjustment instead of their own accounts, as otherwise a timing difference will arise between the recognition of the loss by the syndicate (i.e in the 2009 tax return) and the gain by the member (i.e in the 2008 tax return based on the example above). It follows that members should eliminate (deduct) in their 2008 tax return the gain shown in their 2008 member level accounts in order to avoid double counting.

Members should note that the amount shown on the CTA2 will be included within the foreign exchange adjustment on cash calls generally and will not be distinguished as an amount in relation to excess cash calls. However, if members adjust their tax returns in line with the CTA2, the effect will be that the loss on excess cash calls as shown on the syndicate tax return is cancelled out

So, to summarise the position for corporate members:

Tax return in which the adjustment will be recognised		
2006 YOA	Member's share of exchange loss recorded in syndicate accounts	(£974.72)
2009	Adjustment in CTA2	£974.72
		-
2008	Exchange gain on balance with syndicate as per member's annual accounts	£974.72
2008	deducted for tax purposes	(£974.72)
		-

2009	Net taxable exchange gain/(loss)	NIL

You should note that the dollars held by the syndicate will also be revalued at the year end and a gain of £974.72 will be recorded in the syndicate accounts in respect of this cash held. It is this gain which is recognised for tax purposes and since this is included in the syndicate accounts it is included within the CTA1 result.

Exchange differences in relation to distributions received

Tax Treatment

A foreign exchange gain or loss will also arise in respect of US dollar profits between the date of closure of the year of account and the date the dollars are released by the syndicate to Market Services. Any foreign exchange gain or loss that a member suffers due to a fluctuation in the US $ exchange rate between the date that the year of account closes and the date that the amount is released to Market Services for distribution is taxable or allowable: but no adjustment is required to reflect this in the member's tax return as the amount is reported by the syndicate on the syndicate tax computation and so is included in the CTA1 result.

Accounting Treatment

The syndicate does not record in its accounts the foreign exchange gain or loss arising on US dollar profits due to a movement in exchange rate from the date of closure of the account until the date that the dollars are released to Market Services.

Tax Treatment

Syndicates are required to make an adjustment in the syndicate tax computation to include any foreign exchange gain or loss arising on US dollar profits from the date of closure of the year of account until the date that profits are released to Market Services.

For example, suppose a member is due a US dollar profit distribution of $20,000. At 31 December 2008, when the exchange rate was £1:$1.4, the amount due to the member as shown on the consolidated personal account was £13,888.89. However, when the amount is paid to Market Services in April 2009 the exchange rate is £1:£1.5217, so the sterling value of the distribution is £13,143.19 due to the movement in the US dollar exchange rate.

The syndicate is therefore required to report a foreign exchange loss of £745.70 on the syndicate tax return and this is then reflected in the CTA1 for the member.

Corporate members should follow the CTA1 result rather than their own accounts. It follows that that members should eliminate (add back) the loss shown in their member level accounts in order to avoid double counting.

The above example assumes that the member opts to receive the distribution in sterling. The same adjustment would however also apply if the member receives the distribution in dollars. In this latter case the exchange rate at the date that the dollars were released to Market Services is included on the CTA2 to enable the member to make any further foreign exchange adjustments.