Market Bulletin

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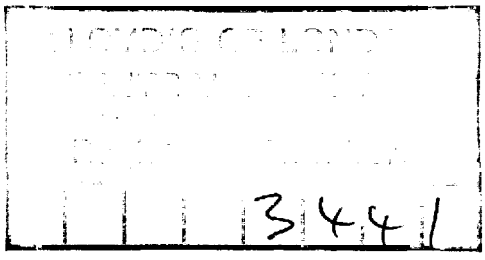


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| **FROM:** | Head of Taxation, Taxation Department |
| **LOCATION:** | **86/430** |
| **EXTENSION:** | **5228** |
| **DATE:** | **22** March 1996 |
| **REFERENCE:** | TAX/VAT/MB/ln/mb0l 15a(Yl 89) |
| **SUBJECT:** | VAT - CHANGE IN ACCOUNTING PROCEEDURE |

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| **ACTION POINTS:** | **Procedures to be followed by managing and members' agents** |
| **DEADLINE:** | **Effective from 1 April 1996** |

The purpose of this Market bulletin is to explain the changes which will take place from 1 April 1996 in respect of UK VAT incurred on claims and the VAT imported services charge which is levied on certain services provided by non-UK suppliers.

This change arises as a result of a High Court judgment last year in the Deutsche Ruck Reinsurance case, which has led to Customs& Excise changing their policy on how expenses incurred on insurance claims should be treated for VAT purposes.

The change in policy impacts on Lloyd's in the following areas :

1. LeBoeuf, Lamb, Greene& MacRae fees incurred centrally and recharged by the Market Financial Services Department;

2. non-UK services processed by the Lloyd's Claims Office (LCO) on behalf of Lloyd's Underwriters;

3. non-UK services received directly by managing and members' agents; and

4. UK VAT incurred in respect of insurance claims processed by LCO.

Before explaining in greater detail the changes involved in each of these four areas, it is necessary to explain some general VAT principles and detail what the Deutsche Ruck case decided.

General VAT principles on insurance

An insurance policy written for an insured belonging in the UK or EC is an exempt supply for VAT purposes. This means that all VAT incurred on expenses directly relating to that policy is non-claimable.

Where an insurance policy is written for an insured belonging outside the EC, the supply is outside the scope with credit (previously known as "zero-rated") and any VAT incurred on expenses directly relating to that policy is fully claimable.

VAT is not only charged on expenses incurred from UK entities. Certain services which are received from non-UK suppliers are charged free of UK VAT but the recipient must charge himself UK VAT thereon. This is known as the reverse or imported services charge. The type of services affected are those of lawyers, accountants, auditors, consultants, etc.

It is not possible at Lloyd's to attribute expenses to individual policies written. Instead, in order to calculate recovery of VAT either charged or self-charged under the Lloyd's VAT Arrangements, managing and members' agents use a VAT recovery rate for expenses which is calculated by reference to the level of premium which gives rise to a right to recover input tax as a proportion of total premium processed. The VAT recovery rates calculated are used in all four areas of expenses identified above.

Deutsche Ruck case

The taxpayer in the Deutsche Ruck case sought to establish that, if after issuing an insurance policy to an insured who belonged outside the EC he incurred VAT on costs (e.g on claims) which were directly attributable to that policy, he should be able to recover VAT on those costs just as if he had incurred them prior to issuing the policy.

As Deutsche Ruck were successful, Customs & Excise have changed their policy and now require all expenses pre and post issue of an insurance policy to be directly attributed. Hence these changes in VAT accounting practices.

Whilst we have agreed an effective date of 1 April 1996 with Customs& Excise for the introduction of these changes, it may also be possible to amend VAT accounting back to 12 August 1993 (the date of the Deutsche Ruck VAT Tribunal decision). This point is expanded on under the heading "Retrospection" on page 4 of this Bulletin.

IMPACT ON LLOYDS

LeBoeuf fees recharged to the Market

Customs & Excise have agreed that all LeBoeuf fees recharged to the Market directly relate to the writing of US policies which are outside the scope with credit. Consequently, the VAT to be accounted for as output tax on the imported service charge on LeBoeuf fees will be fully claimable as input tax. Customs & Excise have therefore agreed that LeBoeuf fees may be excluded from the imported service charge with effect from 1 April 1996. This means that, with effect from (and including) the levy for the first quarter of 1996 (which will be collected in May), MFS will no longer be identifying LeBoeuf charges on invoices, but will simply incorporate these charges in the US situs levy.

Non-UK services processed by the LCO

Application of the VAT imported services charge by reference to individual claims is not possible since the LCO does not hold details of the VAT liability of the policy to which a particular claim relates.

Instead, a survey of imported services was carried out in 1989 which identified the proportion of services provided from overseas to the total claims figures. The resulting percentages,

0.19% for marine
O.44% for non-marine
O.10% for aviation

have been applied by managing agents to the total claims figures advised via the LPSO tabulation sheets and VAT accounted thereon.

The LCO is still unable to link the services supplied to the VAT liability of the policy written, but a new survey has been conducted which only includes EC (but not UK) providers of relevant services. Instead of applying individual percentages to the different business sectors, one percentage will be used for all claims. That figure is 0.04% and will be applied to claims which are given a claims settlement date (the date where the LCCF is processed) of 1 April 1996 or later, VAT will need to be accounted for in full on the resulting amount and none of this VAT will be recoverable.

Non-UKs ervices received direct by members' and managing agents

Where services which are caught by the imported services charge have been supplied direct to a members' or managing agent, the VAT self-charged has in the past been claimed on the basis of the overall recovery rate for the agent in that quarter.

Payments made on or after 1 April 1996 for any such directly incurred expenses should be attributed to the insurance policy to which they relate. If that policy was with an assured belonging in the EC then none of the VAT self-charged can be recovered. But, if the policyholder belongs outside the EC, then all of the VAT self-charged can be recovered.

UK VAT processed by LCO

Currently, where UK VAT is incurred on a claim, LCO will only categorise it as VAT claimable by the managing or members' agents (and advised on the Underwriters Signing Message) if the services were provided to the underwriter. Under a long-standing agreement between the ABI, Lloyd's and Customs& Excise, VAT on claims services are ordinarily claimable by the policyholder,

This treatment will continue to apply with the added requirement now that for any LCCF agreed and initialed by LCO on or after 1 April 1996, LCO will only include the VAT as claimable if it arises on a supply made to the underwriter and the policyholder belongs outside the EC. All such VAT will be recoverable in full, whereas UK VAT processed by the LCO and shown on LCCFS agreed and initialed before that date will be recoverable in part. Underwriters receiving USMs during April 1996 will need to establish from the narrative the date the LCCF was agreed and initialed in order to determine whether the VAT can be claimed in full or part.

After the end of April 1996 LCO will stop showing in the USM narrative field the date on which LCCFS were agreed and initialed. This is because all LCCFS reflected in USMs after the end of April will have been agreed and initialed after 31 March 1996. A further announcement will be made if, for any reason, this does not prove to be the case and USMs issued after the end of April need to continue to show the date on which LCCFs were agreed and initialed.

## Retrospection

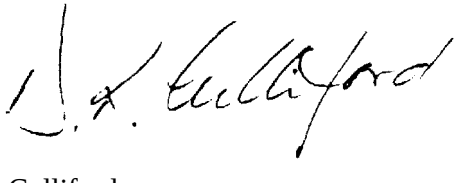
As this change in policy has fairly wide-ranging consequences from a VAT accounting and computer systems perspective. 1 April 1996 was agreed as the most logical implementation date. However, managing agents may be able to take advantage of this change in policy retrospectively, although if they wish to take advantage of the change in policy, they must do so for all affected areas.

It is expected that adjustment across all areas would be beneficial to managing agents if Customs accept that retrospective claims can be made to recover VAT on LeBoeuf fees. Although they accept that VAT on all LeBoeuf fees recharged to the Market can be recovered from 1 April 1996, Customs& Excise do not currently accept that claims can be made to recover such VAT retrospectively to 12 August 1993. Lloyd's is disputing this with Customs & Excise. Furthermore, although only in relation to LeBoeuf fees, we believe there are strong grounds for retrospective y reclaiming VAT back to 1987 rather than 1993 and negotiations with Customs & Excise are continuing on this point.

A further Market Bulletin will be issued as soon as possible giving details of the outcome of Lloyd's discussions with Customs & Excise on retrospective claims to recover VAT on LeBoeuf fees and, if Customs accept that such claims can be made, setting out a suggested means of making such a retrospective recovery calculation (bearing in mind the need for the recalculation to cover all affected areas).

If you have any questions on any aspect of this Market Bulletin, please call Karen Talbot-Martin on Lloyd's extension 5396.

This bulletin is being sent to all underwriting agents, active Underwriters, corporate Names, Lloyd's licensed advisers and recognised auditors.



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