Market Bulletin

LLOYD'S

One Lime Street London EC3M 7HA

FROM:	Head of Taxation
LOCATION:	86/441
EXTENSION:	5228
DATE:	25 February 2003
REFERENCE:	TAX/DHC/Y2998
SUBJECT:	**EXEAT POLICIES AND ESTATE PROTECTION PLANS: FINANCE ACT 2002**
ATTACHMENTS:	None
ACTION POINTS:	To note
DEADLINE:	Effective immediately

1. *Introduction*

1.1 Section 86 of Finance Act 2002 brought in some new tax rules relating to exeat policies and estate protection plans. The new rules, which apply to policies entered into on or after 17 April 2002, remedy some deficiencies in the original legislation under which members could get either too little or too much relief in certain circumstances.

1.2 This bulletin summarises the new rules and sets out what information will be reported on forms CTA2 in order to help members comply with their obligations.

2. *New Tax Rules*

2.1 The new rules apply to exeat policies and certain estate protection plans (EPPs) taken out by individual members. The EPPs concerned are those which provide for a complete reinsurance of a member's liabilities without any retention of risk by that member. The legislation also applies to any equivalent policies taken out by corporate members.

2.2 The legislation uses the term "quota share contracts" to describe those policies which it defines as being within its scope, although it does not in fact apply to all quota share policies. References to "quota share contracts" in this bulletin should be read accordingly.

2.3 The new rules give further relief where a member has paid a cash call to a syndicate and a "quota share contract" comes into effect to reinsure all the liabilities before a loss is declared. In these circumstances, the new legislation allows a tax deduction not only for the "quota share contract" premium, as was provided for by previous legislation, but also for the amount of the cash call. This is an improvement, as otherwise the member would get no tax relief at all for the cash call.

2.4 In the case of a contingent contract such as an EPP, the expression "coming into effect" refers to the time that the contingency is satisfied. In the case of an EPP this will be the date of the member's death.

Example A

A member has paid cash calls to a syndicate of £10,000 relating to its 2000 year of account. In December 2002, before the syndicate has declared any loss, he pays an EPP premium of £500 to cover the calendar year 2003. (Assume the EPP policy is one that qualifies as a "quota share contract" within the terms of the legislation.) This policy reinsures the member for the losses, including the losses in the syndicate to which he paid the cash calls. In February 2003 the member dies, and in June 2003 the syndicate declares a loss of which his share is £21,000.

The tax deductions due to the member in this case will be £500 for the EPP premium, which is deductible according to the payment date of December 2002 (i.e. in 2002-03); and £10,000 in respect of the cash call, which is deductible according to the date of death in February 2003 (i.e. in 2003-04).

2.5 As noted in the above example, for an individual member the premium payment is tax deductible by reference to the calendar year in which it is paid. The cash call is deductible by reference to the calendar year in which the "quota share contract" takes effect. In each case the deduction is due in the income tax year in which that calendar year ends.

2.6 The previous legislation, which applies to contracts entered into before 17 April 2002, could in certain circumstances also have effectively given relief twice over for the same economic loss. This could have happened if a syndicate declared a loss but did not call that loss from its members before a "quota share contract" came into effect. In that case, the member would have got tax relief both for the unpaid loss and for the "quota share contract" premium. In these circumstances, the new legislation operates to restrict the amount of the premium that is deductible for tax purposes.

Example B

A syndicate year of account (1999) declared losses for tax purposes in June 2002, of which a member's share was £12,000. These losses have not yet been called, and the syndicate is now in run-off. In June 2003 the syndicate declares a further loss of which his share is £4,000 but which is also not called. In August 2003 the member pays an exeat premium of £45,000. Under the contract the reinsurer reinsures the member's liability to meet all losses, including the losses of £12,000 and £4,000 which have been declared but not called.

In this case the member will have had a tax loss for the £12,000 according to when the loss was declared (i.e. in 2002-03). He will also have a tax loss for the £4,000 according to when that loss is declared (i.e. in 2003-04). The further tax deduction that is due to the member in respect of the exeat premium will be restricted to £45,000 – (£12,000 + £4,000) = £29,000. This is deductible according to the date the exeat premium is paid, that is in 2003-04. The total amount of tax relief over the two income tax years will therefore be £45,000.

2.7 The new legislation also caters for cases where some, or all, of the losses have been called by comparing the amount paid in as cash calls with the amount of the declared loss that has been reinsured under the "quota share contract". And if, exceptionally, more relief has already been given than the total economic loss to the member, the legislation provides that the difference becomes taxable by reference to the calendar year in which the "quota share contract" takes effect.

Example C

If, in example B above, the member had paid cash calls of £8,000 prior to the purchase of the exeat policy he will still have had a tax loss of £12,000 in 2002-03 and a tax loss of £4,000 in 2003-04. But the further tax deduction due to the member in respect of the exeat premium paid in May 2003 will be restricted to £45,000 – (£12,000+ £4,000 - £8,000) = £37,000. This is deductible according to the date the exeat premium is paid, i.e. in 2003-04. The total amount of tax relief over the two years in this case will therefore be £53,000.

2.8 The application of the legislation is complex, and the above examples do not cover every possible set of circumstances.

3. Completion of tax returns

3.1 During the course of Parliamentary proceedings we pointed out that, in order to operate the new legislation, members need to know whether a contingent contract, such as an EPP, will come into effect or not. This is not possible until the period of cover has expired. We therefore asked for an assurance that members should not be put in the position of having to wait until 31 December in order to complete and submit their income tax returns for the previous income tax year.

3.2 In response to this concern, the Financial Secretary to the Treasury confirmed in Parliament that Lloyd's members, in accordance with normal Inland Revenue practice, will be able to complete their tax returns on the basis of provisional figures which can then be amended if necessary. She said:

"It is, of course, not possible to know for certain until the period covered by the contract has actually ended whether the contract will take effect. For that reason, the actual amount deductible cannot be determined until that time. However, existing law and practice allow an estimate to be made and a deduction claimed at the time that the premium is paid. When the actual amount allowable is finally determined an adjustment may be made if necessary."

4. Provision of information

4.1 Lloyd's Members' Services Unit (Tax Operations) will report on individual members' forms CTA2 amounts that members need to report on their tax returns as further tax deductions or taxable amounts under this legislation as a result of exeat policies or EPPs they have with Centrewrite. MSU cannot at present undertake to provide such information in respect of other insurers, although they are currently exploring the possibility of doing this.

4.2 As the new legislation applies only to policies taken out on or after 17 April 2002 the first CTA2 reports including this information will be for the 2002 calendar year.

5. Readership and contact details

5.1 This bulletin, which has been agreed with the Inland Revenue, is being sent to all members' agents, recognised auditors, personal accountants and members who deal with their own tax affairs.

5.2 If you have any queries about the scope of the new legislation please contact Maureen McLeod on 020 7327 6860. If you have any queries about data provision on forms CTA2 please contact Christine Allcott on 01634 392433.

David Clissitt
Head of Taxation