Market Bulletin

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FROM: Manager - International Tax, Taxation Department.
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REFERENCE: TAX/MCM/hrc/Y517
SUBJECT: INSURANCE PREMIUM TAX - RATE CHANGE

ACTION POINTS: **Brokers and Underwriting Agents to note transitional procedures**

DEADLINE: **1st April 1997**

1. Introduction

1.1 Further to the Market Bulletin dated 2 December 1996 more information is now available on the practical arrangements which underwriters and brokers need to follow as a result of the proposed increase in the rate of insurance premium tax from 2½% to 4% or, if applicable, 17½%.

1.2 Section **2** sets out the technical background and sections 3 and 4 cover the placing and closing procedures, Section 5 explains what will happen if insufficient tax is received with the premium. Sections 2.3, 3.4 and 4.5 explain the procedures for binding authority business and they are summarised in Appendix 1.

1.3 **IT IS IMPORTANT THAT UNDERWRITERS UNDERSTAND THE PRACTICAL ARRANGEMENTS. IF INSUFFICIENT TAXIS RECEIVED WITH THE PREMIUM, UNDERWRITERS WILL BE EXPECTED TO FUND THE SHORTFALL.**

1.4 The procedures set out in this bulletin have been developed in conjunction with London Processing Centre (LPC) and LIBC. A further bulletin will be issued next month about the new higher rate of 17½% when more information is available.

1.5 **Please note that the Finance Bill is still being considered by Parliament and the procedures set out in this bulletin may have to be altered to reflect legislative changes. You will be advised as soon as possible if this happens.**

2. Technical Requirements

2.1 The tax point is the trigger to account for IPT. The tax must be accounted for in the accounting period in which the tax point occurs. The tax point for syndicates which are included in the central tax return is the date of signing by LPSO.

Please note that the tax point is only created when the premium is signed by LPSO; it is not possible to create it b y signing the tax alone.

2.2 The increased rate of 4% and 17½% will apply to all taxable premiums that relate to policies incepting on or after 1 April 1997. The old rate of 2½% will continue to apply to premiums signed by LPSO after that date if the policy incepted before 1 April 1997 for a transitional period. The transitional period will end on 31 July 1997 which means that premiums signed by LPSO on or after 1 August 1997 will be subject to tax at the new rate **even** if the policy incepted before 1 April 1997.

2,3 These provisions apply not only to the signing of original premiums, but also to additional premiums (APs) where the risk in question incepts on or after 1 October 1994 (the date of introduction of IPT for UK business). Declarations under binding authorities, lineslips or brokers' covers must be treated in the same way as open market risks. It is the inception date of each declaration or the effective date of any amendments that determines the rate of IPT applicable not the inception date of the facility contract.

2.4 Return premiums (RPs) qualify for a refund of IPT at the same rate as the tax paid on the original premium. If it is not possible to identify the return premium with a particular premium, the tax refund may be estimated. Acceptable methods of estimation are being discussed with Customs and Excise and further guidance will be given as soon as possible.

2.5 Premium adjustments on contracts originally incepting prior to 1 April 1997 may result in an AP or an RP. The adjustment may cover premiums signed with different tax rates. An AP adjustment signed by LPSO on or after 1 August 1997 will be subject to tax at the new rate. A RP will qualify for a refund at the same rate as the tax paid on the original premium. If it is not possible to calculate this an estimate can be used as explained in 2.4

Where the original risk was subject to tax at 2.5% and a final premium adjustment is signed on or after 1 August 1997, the new rate of tax applies to the adjustment. For example, a premium adjustment AP signed on 1 August 1997 for a risk written on a minimum and deposit premium basis, adjustable at expiry and incepting on 15 July 1996 **will** be subject to tax at 4% or if applicable 17½%.

2.6 UK terrorism risks with premiums ceded to Pool Re also qualify for the new rate of IPT for all risks incepting on or after 1 April 1997. Open market terrorism risks incepting before 1 April 1997 should be signed by LPSO before 1 August 1997 because of the 30 day payment warranty. Therefore, syndicates should not have to fund any additional tax.

For terrorism risks that incepted in 1996 with's 60% deposit premium, the balance of 40% is due at expiry of the risk. If this happens on or after 1 August 1997 the rate of IPT applicable will be 4%.

2.7 For risks that are presented to LPSO for signing using Electronic Closing and Accounting (ECA), the tax point (see 2.1 above) is the Financial Account (FA) signing, i. e when the LPSO signing number and date is allocated. If a Technical Account (TA) is closed before 1 August 1997, but the FA is not presented until on or after that date, the tax rate is 4% or 17.5%.

2.8 Certain types of risk, such as twins insurance and prospective foal insurances do not have a specific inception date. The rate of IPT should therefore be determined by applying the rate applicable to the expected inception date of the risk. Once the insured event has taken place, the IPT should be reassessed and if the amount of tax paid changes, a tax adjustment will be needed to the original amount signed. LPSO will process these tax adjustments as corrections and not new signings.

2.9 Where a risk is underwritten by Lloyd's and ILU or LIRMA members the timing of the signing through each bureau is critical. For example, a risk incepting before 1 April 1997 signed through LPSO during late July will attract 2.5% tax, while the same risk signed through the LPC in early August will attract a tax rate of 4%. Brokers should avoid this situation.

2,10 **There are two special provisions which apply to policies incepting before 1 April 1997.**

The first covers insurance contracts taken out or renewed between Budget day 26 November 1996 and 1 April 1997 which provide for cover commencing before 1 April 1997 and extending beyond 31 March 1998 (unless the insurance is of a sort where it is normal practice for cover to be provided for a period exceeding twelve months). For such contracts the premium is apportioned between cover up to 31 March 1998 and the remainder of the policy, with tax due on 1 April 1998 at 4% or 17½% on the portion that relates to cover after that date.

Examples of types of contracts where it is <u>normal practice</u> for cover to exceed twelve months are single premium creditor insurance, credit gap shortfall insurance, building latent defects policies, mortgage indemnity insurance.

The second applies to policies which incepted before 1 April 1997 and are extended. ITT must be charged at 4% or 17½% on the proportion of the premium which relates to cover from 1 April 1997. This rule does not apply though where the extension has been made for the purposes of avoiding IPT.

3. <u>Placing Procedures</u>

3.1 This section describes the procedures that should be followed when placing a risk, or making an amendment to an existing risk, whether on a paper slip or electronically. It also covers the arrangements for coverholders and lineslip holders operating binding authority contracts or other bulked accounting facilities spanning 1 April 1997.

shown, instead of a percentage. This statement must be provided even where the risk is taxable at one rate.

3.3 For open market AP/RP slip endorsements, it is equally important that the rate of ITT due is shown clearly on the LPO 14lC or D endorsement. The slip endorsement should show the phrase ***"plus x% IPT on y% of gross premium".*** Alternatively, an amount of taxable gross premium can be shown, instead of a percentage. This statement must be provided even where the risk is totally taxable at one rate.

3.4 For binding authorities, lineslips and broker's covers which incept prior to 1 April 1997 and can accept declarations incepting on or after 1 April 1997, the slips must be endorsed with a provision to calculate IPT at the new rates. Instructions should be given to binding authority coverholders to apply the new rates on all business incepting, or amendments to existing declarations that are effective, on or after 1 April 1997. As well as endorsing slips, the existing contract wordings must also be amended by means of a policy/wording endorsement.

A recommended suitable statement to endorse on slips and in wordings is;
It is hereby noted and agreed that declarations qualifying for UK IPT which incept on or after 1 April 1997 must be charged at a rate of 4% (or 17.5% depending on type of business) tax, instead of 2. 5%. This also applies to any APs covering new risks that are effective on or after 1 April 1997.

RPs must be assessed for a tax refired at the same rate as the premium to which the return relates. Until further notice, where it is not possible to relate a return premium to a specific paid premium, the entry must be referred to the lead underwriter for an estimate to be calculated. "

A single page summary of instructions for coverholders has been prepared to assist underwriters and brokers. Please refer to Appendix 1.

The position is different for marine cargo merchant's covers as the assured is the person holding the cover facility, i.e the cover is the contract with the assured. Covers incepting prior to 1 April 1997 therefore continue to be taxable at 2. 5°/0, unless they are signed by LPSO on or after 1 August 1997, while covers that incept on or after 1 April 1997 are taxable at 4%.

3.5 Declarations of premium signed as APs or RPs should be recorded by coverholders or lineslip holders as pre or post 1 April 1997 inceptions and the rate of IPT applicable shown. It is advisable to compile separate bordereau for risks subject to each different rate of IPT. This will greatly assist brokers and the signing bureau when closing premium and tax to underwriters.

3.6 The timing of premiums from coverholders to LPSO via Lloyd's brokers is critical to ensure that the tax collected from assured is the amount due for payment to Customs and Excise. If a 2½% tax rate is used on the bordereau or endorsement for risks incepting before 1 April 1997 but the premium is signed through LPSO or the London Processing Centre after 31 July 1997, tax must be paid at 4%. (Please see section 5).

4. <u>Closing Procedures</u>

4.1 This section describes

“4.2 In order to capture and report different rates of tax and taxable premiums, it is necessary to sign each different tax rate that is applicable to a risk on a separate LPAN. Brokers should therefore complete separate LPANs for each premium and associated tax rate. Box 17 on each LPAN must continue to be completed with Lloyd’s proportion of IPT in settlement currency for a single rate of tax, i. e 2.50/0 or 40/0 or 17. 5°/0.

4.3 LPSO technicians will check the rate of IPT that has been applied to an original premium in relation to its inception, or an AP or RP against the effective date. Where the date is prior to 1 April 1997, the rate is 2.5%. Where the date is after 1 April 1997, or the premium is processed after 31 July 1997, the rate will be 4°/0 or 17. 5°/0, depending on the business involved. It is therefore important that brokers show the inception date of the risk or effective date of the premium clearly on the slip.

4.4 LPSO will check all binding authorities, lineslips or brokers’ covers incepting prior to 1 April 1997, which can accept declarations incepting on or after 1 April 1997, for the addition of a statement stating that the new rate(s) of tax will apply for these declarations. Brokers should therefore complete an LPO 141 C or D slip endorsement and have it agreed by the leading Lloyd’s underwriter. Where the facility wording has already been signed, a wording addendum should also be prepared and submitted to LPSO for signing. The checks will be carried out from 1 March 1997 on taxable facilities presented for AP/RP signing, and wordings which are submitted for signing,

4.5 From 1 April 1997 when AP/RP declarations are submitted for signing, brokers must clearly identify the premium;

- as pre 1 October 1994 risk (if applicable)
- as pre or post 1 April 1997 risks

and

- the rate(s) of tax applicable to each taxable premium declared.

This can be on slip endorsements, bookslips or bordereau. Where declarations are signed by LPSO after 31 July 1997, the new rate(s) of IPT will apply, irrespective of the inception dates of the risks involved. LPSO will check that the correct rate of tax has been applied in relation to the inception date(s) declared.

Separate LPANs are needed for each total amount of gross premium declared at different tax rates. Any non-taxable premium may be signed by inclusion on any other LPANs being presented. Separate LPANs for non-taxable business are not necessary.

4.6 RP's relating to taxable premiums will be checked by LPSO to make sure the refund of tax is processed at the same rate of tax applied to the original premium. It is important that the return premium is identified with a specific premium payment but see 2.4 where this is not possible.

4.7 When an AP or RP is processed that relates to the whole contract, such as a profit commission or premium adjustment, brokers should obtain the agreement of the leading underwriter (as specified in the terms of the slip) to the rate or amount of tax to be refunded. This composite payment or return of tax can be processed by LPSO on one LPAN,

4.8

'4.9 Long term contracts such as construction risks which originally incepted prior to 1 April 1997, but are subject to annual resigning or premium transfer after 1 April 1997 need special consideration. Annual re-signings are taxable at the rate of IPT applicable when the annual installment is signed by LPSO irrespective of when the contract originally incepted. All annual re-signings signed on or after 1 August 1997 are taxable at 4°/0.

4.10 Premium transfers are internal movements of premium between years of account where the total ITT due was paid at the time of signing the total original premium. All premium transfer signings are non-taxable.

4.11 Any taxable deferred signings processed prior to 1 April 1997, containing installment payment dates after 1 April 1997, remain taxable at 2.5% because the total IPT is paid when the premium is signed.

4.12 LPSO will not accept a slip showing "tax as applicable" for risks subject to UK IPT. The correct way of showing the taxis described in sections 3.2 and 3.3 of this bulletin.

Brokers and underwriters should note that work will be processed in strict presentation date order. LPSO will make every effort to sign as many risks, which incept before 1 April 1997, as possible before 31 July 1997. Premiums cannot be back-dated and brokers must present entries as early as possible in July 1997 for inclusion as July signings. Brokers are advised to present premiums incepting prior to 1 April 1997 subject to IPT under the Urgent signings procedure and clearly mark them as "IPT requiring a signing by 31 July 1997".

Where it is necessary for LPSO to query a taxable item, every effort will be made to resolve the query by telephone with the broker to achieve a signing by 31 July 1997. If a premium is rejected by LPSO, brokers must treat it as high priority and return the amended item as quickly as possible.

5. <u>Payment of correct tax on post 1 August 1997 signings</u>

5.1 Original premiums, APs or RPs signed by LPSO on or after 1 August 1997 for policies incepting on or after 1 October 1994 will attract the new rates of tax. As it is the legal responsibility of an insurer to pay the correct amount of tax to the Customs and Excise, irrespective of the amount actually collected from the assured, underwriters will be expected to fund any shortfall of tax. If this happens, LPSO will query each such signing with the broker and ask for the agreement of the leading underwriter(s) as specified in the terms of the slip for the funding of the amount required to make the correct tax payment. LPSO will also ask for the slip to be endorsed to reflect the actual rate of tax that will apply to the premium closed to Lloyd's.

If the LPSO and LPC/ILU/LIRMA signings span 1 August 1997 the risk or declarations will be taxable at different rates for each market and slips, endorsements, policies or certificates should reflect this.

5.2 **There are certain methods of closing premiums to underwriters which may help ensure that the tax payable to Customs and Excise equals the tax collected from the assured.**

- * **deferred settlement scheme**
- * **flexible settlement scheme**
- * **monthly declarations instead of quarterly declarations for the period relating to risks incepting prior to 1 April 1997.**

All other rules and procedures relating to the operation of IPT remain unchanged.

6. Conclusion

6.1 Representations have been made to Customs and Excise about a number of the new proposals, in particular the operation of the cut-off date of 31 July. The proposals may be changed before the Finance Bill becomes law. For the time being though, it seems prudent for underwriters and brokers to work on the assumption that premiums signed on or after 1 August 1997 will be subject to tax at 4°/0 or if applicable 17*,0/0.

This bulletin has been sent to all active underwriters, managing agents, Lloyd's brokers and recognised auditors. If you have any general queries, please contact me on extension 6860. Queries on the placing and closing procedures should be addressed to the business support helpline on extension 2400.

Maureen McLeod

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Taxation Department

Attachment

INSTRUCTIONS FOR COVERHOLDERS

(effective immediately)

The following notes summarise the procedures covering the Insurance Premium Tax (IPT) :

- The new tax rates of 4% and 17.5% must be charged on all risks incepting on or after 1 April 1997, whether new business or renewals.
- The new rates of 4% and 17.5'% apply to APs covering new risks which have effective dates on or after 1 April 1997.
- Records must be kept showing the rate of tax charged on each premium.
- Records must be kept showing the method of apportionment used, if any, to determine the amount of gross premium subject to tax.
- Any return premiums should have the same rate of tax as the original premium. If it is not possible to link a return premium to a specific incoming premium, for example, with a profit commission or premium adjustment the return must be referred to the leading underwriter for an estimated tax refund calculated at a composite rate.
- Premium adjustments on risks that were charged at 2.5% and which will be processed by LPSO to underwriters after 1 August 1997, must be charged at the new rates of 4% or 17.5°/0.
- Bordereau should be summarised for underwriting purposes and closing to LPSO, showing :

  separate total amounts of pre and post 1 April 1997 taxable gross premiums.

  the rate of tax applicable to each totalled taxable gross premium.

  For example :

Tax rate	Pre 1 April taxable gross premium	Post 1 April taxable gross premium
2.5%		
4%	None possible	
17.5%	None possible	
Composite rate	None possible	