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SUBJECT: SYNDICATE CAPACITY - TAXATION
IMPLICATIONS FOR INDIVIDUAL MEMBERS
SUBJECT AREA(S):
ATTACHMENTS: Appendix
ACTION POINTS: Personal accountants and Names who deal with
their own tax affairs to note
DEADLINE: To apply to acquisitions and disposals of capacity
with effect from 6 April 1999

1. Introduction

- 1.1 The purpose of this market bulletin is to advise individual members, their tax advisers and agents of a number of recent tax changes relating to syndicate capacity (or syndicate rights as they are also known). These changes arise as a result of the new legislation in sections 82-84 of Finance Act 1999 which applies from 6 April 1999. The bulletin also summarises the more common tax issues relating to syndicate capacity. Members should note that this bulletin does not apply to corporate members.
- 1.2 The most significant effect of the new legislation is to include syndicate capacity in the list of assets which can qualify for roll-over relief. This is detailed in 3 below. In addition, the new legislation incorporates many of the simplified arrangements which, prior to 6 April 1999, applied to MAPA transactions on a concessionary basis. However, there are some differences to these arrangements which are detailed in 4.
- 1.3 This bulletin contains various terms used in the capital gains tax legislation of which the reader will need some knowledge to fully appreciate the guidance given. Although the bulletin summarises most of the tax issues, further information may also be obtained from previous bulletins on this subject issued on 8 March 1996, 28 August 1998 and 4 February 1999. Where any previous advice appears contradictory to that provided here, the guidance in this bulletin takes precedence.

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3. Roll-over relief

- 3.1 With effect from 6 April 1999, gains made on the disposal of syndicate capacity, whether held directly or through a MAPA, will be eligible for roll-over relief under Section 152 of the Taxation of Chargeable Gains Act 1992. This means that a capital gain arising on the disposal of capacity may be deferred as long as the consideration received is reinvested in another qualifying business asset within the period beginning 12 months before, and ending 3 years after the date of the disposal. Please note that it cannot be reinvested into an acquisition of capacity prior to 6 April 1999, although relief can be claimed on reinvestment into other qualifying business assets before that date.

Similarly, gains made on the disposal of other qualifying business assets may be rolled into acquisitions of syndicate capacity acquired after 5 April 1999.

- 3.2 Members should note that only certain assets qualify for roll-over relief. These are listed in Section 155 of the Taxation of Chargeable Gains Act 1992 and include, amongst other things, land and buildings used and occupied for the purposes of a trade. Shares are not included. Therefore, with the exception of syndicate capacity, members are only likely to have other qualifying business assets if they have another business outside Lloyd's.
- 3.3 For details about the interaction of roll-over relief and taper relief, please see 7 below.

4. MAPA membership

- 4.1 The following is applicable with effect from 6 April 1999. Please note that points (i) to (iii) also reflect the practice prior to 6 April 1999.
- i) Syndicate capacity held via a MAPA will be treated as a single asset acquired when entering the MAPA arrangement, i.e. it is not necessary to look through the MAPA to see the various syndicate rights of which it is comprised. Where a member has two or more MAPAs, each MAPA is considered to be a separate asset.

- ii) The base cost of the MAPA capacity will equal the consideration paid.
- iii) Any payments made to a MAPA member (including payments into any fund controlled by him) will result in either a disposal or a part disposal of MAPA capacity.
- iv) Further payments made by a MAPA member to fund further capacity acquisition will be treated as enhancement expenditure.
- v) Transfers of the bespoke capacity into a MAPA will be chargeable occasions for capital gains tax (CGT) purposes. The disposal consideration will be the market value of the bespoke capacity at the time of the transfer.
- vi) Transfers of capacity out of a MAPA to be held on a bespoke basis will be chargeable occasions for CGT purposes. The disposal consideration will be the market value of the capacity at the date of the transfer out of the MAPA.
- vii) Any gains arising out of any of the events listed above will be eligible for roll-over relief as per 3 above. Accordingly, it will be possible to defer gains arising in (v) and (vi) above as the consideration for the disposal (either MAPA capacity or bespoke capacity) will be immediately reinvested in other capacity (either bespoke capacity or MAPA capacity).

4.2 For MAPAs existing at 6 April 1999, the following transitional arrangements apply :

- i) MAPA members will be deemed to have acquired the MAPA capacity at the time of the first acquisition of any of the syndicate rights held in the MAPA immediately before 6 April 1999.
- ii) The base cost of such capacity will equal the consideration paid for the rights held in the MAPA immediately before 6 April 1999.

5. Enhancement expenditure

5.1 Where a member owns capacity in any particular MAPA and then acquires further capacity in that MAPA at a later date, this will be treated as enhancement expenditure. On a subsequent disposal of capacity :

- i) if not all the capacity in the MAPA is disposed of, the part disposal rules apply; and
- ii) business asset taper relief will be calculated by reference to the date of the initial acquisition.

5.2 The Inland Revenue have advised that the same rules apply where a member owns bespoke capacity and later acquires further bespoke capacity in the same syndicate. In these circumstances the further acquisition will be treated as enhancement expenditure, with the same consequences for the calculation of any gain on a subsequent disposal, i.e

- i) if not all the capacity is disposed of, the part-disposal rules apply; and
- ii) business asset taper relief will be calculated by reference to the date of the initial acquisition.

5.3 The rules regarding MAPA participation are contained in the 1999 Finance Act. The treatment of bespoke capacity represents a change of view by the Inland Revenue on the proper interpretation of the pre-existing legislation. (Market bulletins of 8 March 1996 and 28 August 1998 outlined their previous view that capacity should be treated in a similar way to shares and securities.)

6. Taper Relief

6.1 Gains arising on the disposal of syndicate capacity, whether held directly or through a MAPA, will be eligible for business taper relief. In order to calculate the amount of relief due, records of the exact dates of transactions must be kept.

The level of taper relief is as follows :

Gains on disposal of business assets	
Number of whole years in qualifying period	Percentage of gain chargeable
1	92.5
2	85
3	77.5
4	70
5	62.5
6	55
7	47.5
8	40
9	32.5
10	25

6.2 *Example of enhancement expenditure and taper relief :*

- i) A £1m line on syndicate A is acquired on 14 July 1999 for £50,000.
- ii) A further £500,000 line on syndicate A is acquired on 12 July 2000 for £40,000 so that the £1.5m line is now a single asset for CGT purposes with a cost of £90,000.
- iii) A £300,000 line on syndicate A is sold on 8 August 2001 for £30,000.
- iv) The annual exemption and incidental costs of acquisition/disposal are ignored.

Tax year 2001/02 :	£
Proceeds	30,000
Less cost (part disposal) :	
90,000 x 30,000/(30,000 +120,000 ⁽¹⁾)	<u>18,000</u>
Gain before taper	<u>12,000</u>
Percentage of gain chargeable because asset held for 2 whole years – 85% (i.e. taper relief available = £1,800)	<u>10,200</u>

(1) If a £300,000 line is worth £30,000, the remaining £1.2m line is worth £120,000.

7. Interaction between roll-over relief and taper relief

- 7.1 Members should note that a claim for roll-over relief will defer an **untapered** gain. When the asset (into which the gain has been rolled) is eventually sold, and assuming that a second claim to roll-over relief is not made, taper relief will be calculated by reference to the date of acquisition of the second asset and not the date of the acquisition of the first. Hence members should be aware that, in some circumstances, it may not be beneficial for a claim for roll-over relief to be made.
- 7.2 The decision to claim roll-over relief is something for an individual member to decide and will depend on a number of factors including how long the second asset will be held, the likely gain (if any) which will be made on the subsequent sale of the second asset and the individual's tax position at the time of each disposal. This is something on which members may well want to take professional advice. For illustrative purposes only, an example is given in the attached appendix showing how the mechanics of roll-over relief work. The Inland Revenue Helpsheet IR 290 also provides some guidance on claiming roll-over relief.

8. Retirement relief

- 8.1 Retirement relief is available to reduce qualifying gains on the disposal of syndicate capacity if the following conditions are met :
- i) the member has been a member of Lloyd's for more than one year, and
 - ii) at the date of disposal the member is at least 50 years of age or has retired on the grounds of ill health, and
 - iii) a disposal of whole or part of the business is made. The Inland Revenue's view is that a disposal of some, but not all, syndicate capacity does not constitute a disposal of part of the business but merely a reduction in its scale. Therefore they believe that, for retirement relief to be available, all of a member's syndicate capacity must be disposed of in any one year such that he does not underwrite in the following year of account.
- 8.2 The relief is on a sliding scale starting at 10% of the maximum relief where the individual has been in business for exactly one year by the date of disposal, increasing to 100% where he has been in business for 10 years or more. The length of time he has owned that particular capacity being sold is irrelevant.
- 8.3 Retirement relief is to be phased out over the next few years as follows :

Qualifying disposal in	Full relief on qualifying gains up to	Half relief on qualifying gains between	
		£	£
1999/00	200,000	200,001	800,000
2000/01	150,000	150,001	600,000
2001/02	100,000	100,001	400,000
2002/03	50,000	50,001	200,000
2003/04	Nil	Nil	Nil

9. Conversion

- 9.1 The sale of capacity to a corporate vehicle in exchange for shares is a disposal for CGT purposes. The deemed proceeds will be the market value of the shares acquired which will be a matter between the converting member and the company issuing the shares. Any gain may be reduced or eliminated by retirement relief if the appropriate conditions are satisfied. The gain may also be eligible for roll-over relief if the consideration is reinvested into a qualifying business asset. Please note that shares are **not** qualifying business assets for the purposes of roll-over relief. See 3.2.
- 9.2 A gift of capacity to a corporate vehicle (e.g a Nameco) is also a disposal for CGT purposes. In this situation a member may be able to claim hold-over relief under s165 TCGA 1992 (relief for gifts of business assets) if the appropriate conditions are satisfied. Members should be aware that an exchange of capacity for shares is not a gift of capacity and, in this respect, are advised to seek advice to ensure that the relief will apply to their particular method of conversion.
- 9.3 Where a member converts to limited liability underwriting via a Scottish Limited Partnership (SLP), no capital gain will arise on the contribution of capacity to the SLP provided that all of the value of the capacity transferred (as ascertained and registered for the purposes of the Limited Partnerships Act 1907) is credited to the capital account in the books of the partnership and not revalued and his capital account is not subsequently credited (except on account of a further contribution of capacity or cash by way of capital) or debited until he leaves the partnership.

10. Other issues

10.1 Mergers

- i) Where two or more syndicates merge **and** the members who participated on the merging syndicates neither receive cash as a result of the merger nor pay cash to continue underwriting in the merged syndicate in the following underwriting account, this is not a chargeable disposal for CGT purposes. Any base cost in the original syndicate will become that of the merged syndicate. Any subsequent sales of capacity in the new merged syndicate will be a chargeable disposal as normal.
- ii) MAPA mergers will not constitute chargeable occasions, provided the members who continue underwriting in the merged MAPA do not receive a cash distribution and the transaction is a genuine merger of two or more MAPAs and does not involve the member in leaving one MAPA and joining another. The Inland Revenue have pointed out that this will depend on the precise terms of the arrangement.

10.2 Entrance fees

The initial entrance or admission fee payable by members on joining Lloyd's is regarded as an incidental capital expense of disposal and thus can be included as such in any capital gain/loss computation. Claims to relieve this expenditure can be made once a member has resigned.

11. Information to be provided by agents

11.1 Agents should note that the tax changes mean that the information they provide to members must be modified slightly with effect from 6 April 1999. The following points include details of the minimum information that should now be provided to members.

11.2 *Bespoke capacity*

- Transactions should be kept separate from MAPA capacity.
- Sales and purchases should be clearly separated.
- The dates of disposal and acquisition should be provided.
- Each transaction should be itemised.
- If disposed of by conversion, the value of the capacity at conversion should be shown.

11.3 *MAPA capacity*

- The date and amount paid on joining a MAPA.
- The date and amount of any further payment made by the MAPA member to fund the acquisition of further capacity.
- The date and amount of any cash payments made to MAPA members as a result of surpluses arising in the auctions or as a result of the sale of MAPA capacity.
- The market value of the member's remaining share of MAPA capacity immediately after any cash payment is made to him.
- The date and market value of any bespoke capacity transferred into a MAPA.
- The date and market value of any MAPA capacity transferred out of a MAPA to be held on a bespoke basis.
- If disposed of by conversion, the value of the capacity at conversion.

The content of this bulletin has been agreed with the Inland Revenue and is being sent to all underwriting agents, recognised auditors, members' personal accountants and members dealing with their own tax affairs. If you have any queries, please contact either Helen Bailey on Lloyd's extension 6839 or myself on Lloyd's extension 5228.

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APPENDIX**Example of interaction between roll-over relief and taper relief :**

- i) £50,000 worth of syndicate capacity A is acquired on 14 July 1999.
- ii) On 10 August 2005 this capacity is sold for £90,000.
- iii) On 17 August 2005 £90,000 worth of syndicate capacity B is acquired.
- iv) On 19 July 2006 this capacity is sold for £120,000.
- v) The annual exemption and incidental costs of acquisition/disposal are ignored.

	<u>Roll-over relief claimed</u> £	<u>Roll-over relief not claimed</u> £
Tax year 2005/6 :		
Proceeds	90,000	90,000
Less cost	<u>50,000</u>	<u>50,000</u>
Gain rolled over ⁽¹⁾ /Gain before taper ⁽²⁾	<u>40,000</u> ⁽¹⁾	<u>40,000</u> ⁽²⁾
Percentage of gain chargeable because asset held for 6 whole years – 55% (i.e. taper relief available = £18,000)		<u>22,000</u>
Tax year 2006/7 :		
	£	
Proceeds	120,000	120,000
Less cost	90,000	90,000
Less rolled over gain	<u>40,000</u>	
	<u>50,000</u>	
Gain	<u>70,000</u>	<u>30,000</u>

Note : No taper relief is due because syndicate capacity B has not been held for one whole year.

In this example, total gains of £70,000 are recognised in 2006/7 if roll-over relief is claimed. This compares to total gains of £52,000 if roll-over relief is not claimed (£22,000 in 2005/6 and £30,000 in 2006/7).

Please note that this example is given solely to illustrate the mechanics of roll-over relief and not to recommend any particular course of action. If different facts are used, especially as far as the respective length of ownership of assets A and B are concerned, a different result will arise.