

**FROM:** Head of Taxation, Taxation Department  
**LOCATION:** TAX/58/323  
**EXTENSION:** 5228  
**DATE:** 21 February 2000  
**REFERENCE:** TAX/MCM/In/Y2240  
**SUBJECT:** SPECIAL RESERVE FUND: TAX CHANGES  
**ATTACHMENTS:** None  
**ACTION POINTS:** Members and members' agents to note  
**DEADLINE:** Immediate

## **1. Introduction**

- 1.1 This bulletin outlines a number of changes to the tax treatment of the Special Reserve Fund (SRF). Its content has been agreed with the Inland Revenue and with Members' Services Unit.
- 1.2 Section 2 of the bulletin describes a number of changes that have been made by Inland Revenue Regulations laid before Parliament in December 1999. These regulations, the Lloyd's Underwriters (Special Reserve Fund) Regulations 1999 (SI No 1999/3308), amend the legislation governing the SRF in Finance Act 1993.
- 1.3 Section 3 of the bulletin outlines some further changes that are to be made to the SRF arrangements, subject to Inland Revenue approval of the detail.

## **2. Inland Revenue Regulations**

### *Maximum amount in the SRF*

- 2.1 The assets in each member's SRF are valued by Members' Funds Department on 31 December each year. Under the previous tax rules, the maximum amount that could be held in the SRF was 50% of the member's overall premium limit (OPL) for that year. If the member did not accept premiums in that year, the last underwriting year for which he or she did so was used instead. Under the new tax rules, the maximum amount of the SRF is 50% of the member's OPL for that year, or 50% of the OPL for the preceding year if that is higher. If a member did not accept premiums in either of those years, the maximum amount is 50% of the OPL for the last year in which he or she did accept premiums.

This change, which takes effect from 31 December 1999, will increase the amounts that some members can transfer into or retain within the tax-favourable environment of the SRF.

#### *Cessation of underwriting*

2.2 When a member ceases underwriting, the SRF is repaid to him or her, and its value is treated as trading income. However, due to a defect in the original legislation certain payments into the SRF in the final year were not included as part of the taxable result. The new Regulations rectify this anomaly by providing that the tax charge should be based on:

- the annual valuation at 31 December immediately prior to the year of cessation for income tax purposes (which is usually the year in which the Lloyd's Deposit is released);
- adjusted for payments made into the fund in the final year, including stop loss recoveries, any transfer made from the underwriting profit for the final year, and investment income and capital appreciation and depreciation.

This change takes effect in relation to payments and transfers made on or after 1 January 2000.

#### *Transfer of assets on cessation*

2.3 When assets in the SRF are transferred to a member on cessation, he or she is treated for capital gains tax purposes as acquiring the assets at their market value as at the 31 December immediately prior to the year of cessation. However, the previous legislation did not adequately address two situations.

The first is where an asset that is transferred on cessation was acquired by the trustee of the SRF during the final underwriting year. The new Regulations provide that, in these circumstances, the member is treated as having acquired the asset at the date on which, and for the consideration for which, the asset was acquired by the trustee.

The second is where, exceptionally, assets held in the SRF are transferred to the member before the end of the penultimate year. This could happen if, for example, there is a delay in releasing the whole or part of the Lloyd's Deposit. In this situation, the new Regulations deem the member to have acquired them at the date of the transfer and for consideration equal to the market value on that date.

These changes have effect in relation to transfers of assets made on or after 1 January 2000.

#### *Deceased members*

2.4 When a member dies, the value of the SRF is taxable as part of the income for final year of assessment for which the deceased member is assessed personally. However, the valuation of the SRF must take into account payments made into and out of the fund after death, and so the amount of the taxable income cannot be determined until after the trade has ceased. A potential interest charge therefore arises on any tax that is due from the deceased member.

The new Regulations reduce this potential charge by bringing the interest calculation into line with that which arises when members resign. The tax remains due for the deceased member's final year of assessment, but any interest charge will be calculated as if the tax were payable for the personal representatives' final year of assessment.

This change has effect in relation to tax that is charged in assessments from the 2000-01 income tax year onwards. This means that it will apply where the date of death is on or after 1 January 2001. The Inland Revenue is currently considering the position for any deceased members who are subject to the previous legislation, and it is hoped that the position with respect to these members will be clarified shortly.

### **3. Proposed changes to the SRF arrangements**

- 3.1 The Inland Revenue has indicated that it will, in principle, approve some further changes to the SRF arrangements. These will not require any further tax legislation, but the detailed arrangements will need to be approved by the Inland Revenue before they come into effect. The changes concern transfers into and out of the SRF in non-sterling currencies (particularly US dollars), and the buying and selling of assets between the member and the SRF.

#### *US dollar payments*

- 3.2 Under the current arrangements transfers can only be made in sterling, even though members can have US dollar profits and can face US dollar cash calls and losses. It is proposed that these arrangements should be altered with effect from the 1997 Account so members will be able to make transfers into the SRF in US dollars. It is also proposed that US dollar withdrawals should be allowed from the Fund.

Members should note that the transfer of US dollars into the SRF will have tax implications. Further advice on these will be given when the detailed arrangements are agreed.

#### *Buying and selling assets from the SRF*

- 3.3 It is proposed that changes should be made to the arrangements to clarify the circumstances in which members may buy assets from, or sell assets to, the trustee of the SRF.

The sale of a chargeable asset by a member to the trustee of the SRF is a disposal for capital gains tax purposes of that asset for a consideration equal to its market value at the time of the transfer. Likewise, the purchase of an asset from the trustee is an acquisition for a consideration equal to the market value of the asset at the time of purchase.

### **4. Amendments to SRF manual**

- 4.1 The Special Reserve Fund Manual will be amended in due course to reflect and implement these proposed changes. Council will also consider any changes that may be necessary to the Special Reserve Fund Trust Deed.

**5. Readership and contact details**

- 5.1 This bulletin is being sent to all members' agents, members' tax advisers and members who deal with their own tax affairs. If you have any queries, please contact Roger Ramage on Lloyd's extension 6852 or Maureen McLeod on extension 6860.

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