



Tax Newsletter

October 2016

Welcome to the Autumn 2016 edition of the Argenta Tax & Corporate Services Limited (ATCSL) Tax Newsletter. There has been much discussion over the last eighteen months between Member's Agents, Lloyd's and HMRC concerning Inheritance Tax (IHT) and Membership of Lloyd's. We thought it would be useful to provide an update on the issues discussed and what it means for you. IHT is a key issue for many of our clients, and, the newsletter includes an important message for our unlimited Members of Lloyd's who are reminded of the consequences of holding a Special Reserve Fund (SRF). In particular, the implications of our recent discussions with HMRC over the availability of Business Property Relief (BPR).

1. Death and BPR

Over the last 18 months, there has been considerable pushback from HMRC on the availability of BPR on the estates of Members of Lloyd's. We are handling a number of client cases and have held meetings with HMRC's valuation team to explore more generically their interpretation of what might qualify for BPR.

HMRC's starting point for recognising the value of assets that qualify for BPR is the latest Coming into Line (CIL) report. HMRC does not accept our arguments that an underwriting business may need extra funding to guard against catastrophe losses or to support increased underwriting activity when the time is right. We have also raised technical challenges around solvency credits (which are shown gross of tax on the Solvency Statement) which will eventually be subject to income tax or corporation tax. Again, this line of argument has fallen on deaf ears. HMRC have stated that when dealing with estates of Lloyd's Members, they are not prepared to commit to a template incorporating set ratios that could be used to deal with BPR claims. They insist that BPR claims have to be determined on an individual case basis in light of the facts. Their starting point for the valuation is the latest CIL report, with a small margin on top where executors can justify the excess e.g. if they can demonstrate that the Member is expecting large losses to be incurred at the date of death.

In summary, HMRC are proving to be very inflexible on this matter and have spent considerable time researching and understanding capital requirements at Lloyd's. Given HMRC's stance, it is more important than ever that clients obtain appropriate advice to ensure they are properly represented in dealings with HMRC on this matter. In our experience, solicitors and executors are not au fait with the latest developments with HMRC. ATCSL has worked closely with a number of clients during the last 18 months. In each case, the client's overall negotiating position with HMRC has been improved through ATCSL's engagement.

2. Bank Guarantees (BG)

For those of you that underwrite through a limited liability vehicle, Finance Act 2013 introduced a new provision that seeks to limit the availability of BPR. This anti-avoidance legislation seeks to match a liability with the asset it supports. In discussions with HMRC, its view is that a BG is a liability that should be deducted from the Lloyd's underwriting assets (which receive 100% BPR), rather than from the collateralised (probably non-BPR) assets, thus increasing the value of the estate for inheritance tax purposes by the value of a BG. If HMRC is correct in their interpretation, it will apply where a member takes out a new BG (or makes changes to an existing one post 6 April 2013).

We have made little progress with HMRC on this matter during the last 12 months. With that in mind, it may require HMRC to open an enquiry into a BPR claim made under this set of circumstances for the interpretation of this legislation to be properly debated.

3. Special Reserve Fund

As you should be aware, for Members who have converted from unlimited underwriting to a limited liability vehicle, Lloyd's have introduced rules to end interavailability, which then triggers the release of SRF. This clears up an issue that HMRC have long been unhappy about where members maintained their FAL as interavailable so that they did not have to release their SRF.

Many unlimited members have built up large SRFs (but restricted to a maximum of 50% of PIL) which has resulted in the overall FAL requirement being overfunded. Here is an example of how a member could be impacted at death by an overfunded SRF:

	£
Overfunded SRF	1,000,000
Maximum income tax due on release of SRF on death	(450,000)
	<hr/> 550,000
IHT at 40%	(220,000)
Net cash available to the estate	<hr/> 330,000

The executors of the estate are faced with an effective tax rate of 67% for the overfunded SRF! Many clients are under the misapprehension that an overfunded SRF is worth retaining as it avoids an income tax liability, but this is not the case, it is purely a deferral of the liability. The example shows that appropriate consideration should be given to an overfunded SRF.

Even for those clients that are aware that their SRF is too large and want to avoid an income tax and IHT double hit at death, their options may be limited. Under the Lloyd's SRF rules, a minimum of 30% of a member's PIL must comprise non-SRF FAL. By way of example:

	£		£
PIL	£2m	SRF	700,000
		Non SRF	600,000
FAL requirement	800,000	Total Capital	1,300,000

The above example shows that FAL is overfunded by £500,000 (£1,300,000 - £800,000), but what can a Member, who is concerned about the threat of challenge by HMRC on the availability of BPR on death, do about it?

The SRF can only be reduced to settle underwriting losses or on cessation. The current balance (£700,000) is well below the 50% of PIL threshold so cannot be released.

The non-SRF capital can only be reduced to the extent it provides a minimum of 30% of overall FAL so it cannot be released either!

To limit the risk of challenge from HMRC on death, the only actions open to the client would be:

- conversion in 2018 (to enable the SRF to be released),
- reduced level of underwriting so that some of the SRF can be released, or,
- increased level of underwriting in 2017 (where appropriate).

We recommend that all unlimited Members review the composition of their FAL balances, and, where necessary, plan appropriate action. In particular, unlimited Members should consider whether further contributions are worthwhile.



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