HM Revenue & Customs

Lloyd's: Stop-Loss Insurance

Who is likely to be affected?

Corporate members of Lloyd's of London (Lloyd's) and corporate partners in a partnership that is a member of Lloyd's (both referred to as 'corporate bodies' from this point) who take out stop-loss insurance at member-level.

General description of the measure

This measure will amend the tax treatment of premiums incurred by Lloyd's corporate bodies for member-level stop-loss insurance. It aims to align the timing of the tax deduction for the premiums with the recognition of the profits to which they relate.

Policy objective

To ensure that member-level stop-loss reinsurance premiums cannot be deducted at an earlier date than the date on which profits from the reinsured underwriting business are taxed.

Background to the measure

Stop-loss insurance is a type of re-insurance contract which can be used by members of Lloyd's to insure against exposure to risk. This is in addition to insurance taken out at Lloyd's syndicate level.

The premiums incurred by Lloyd's corporate bodies for stop-loss insurance taken out at member-level will be taxed on the declaration basis and not on an annual basis as is currently the case.

The declaration basis is a tax treatment specific to Lloyd's. It allows the recognition of the profit or loss arising directly from the corporate body's syndicate membership for any particular underwriting year to be deferred for tax purposes until after that underwriting year has closed. The underwriting year closes after three years (that is at the 36 month point) with the result that the profit or loss is recognised for tax purposes in year four, the period in which the profit or loss is declared.

This measure was first announced at Budget 2011. The Government has held informal consultations with Lloyd's and interested parties.

Detailed proposal

Operative date

The measure will have effect from 6 December 2011.

Current law

The current law, set out in Chapter V Part IV of Finance Act 1994 (FA 1994), allows a deduction for stop-loss premiums incurred at member-level by participants in a Lloyd's syndicate in the year in which the expense is incurred rather than in the year in which the profits from the reinsured business are declared under the declaration basis.

Proposed revisions

Legislation will be introduced in Finance Bill 2012 to amend FA 1994 to provide that any stop-loss reinsurance (as defined for tax purposes in FA 1994) taken out by a Lloyd's corporate body is to be dealt with for tax purposes on the declaration basis.

Summary of impacts

<table>
<tr><td rowspan="3">Exchequer impact (£m)</td><td>2011-12</td><td>2012-13</td><td>2013-14</td><td>2014-15</td><td>2015-16</td></tr>
<tr><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td colspan="5">This measure is expected to increase receipts by approximately £200 million a year over the period in which the timing advantage unwinds. The final costing will be subject to scrutiny by the Office for Budget Responsibility, and set out at Budget 2012.</td></tr>
<tr><td>Economic impact</td><td colspan="5">No impact on investment, employment or consumption is anticipated. The objective is to address the timing mismatch. It is not designed to affect underlying economic behaviour.</td></tr>
<tr><td>Impact on individuals and households</td><td colspan="5">The measure will not impact on individuals and households as it applies to Lloyd's corporate bodies underwriting insurance at Lloyd's only. It will not affect individual Lloyd's members (often referred to as 'Names') or individuals who are partners in a partnership that is a member of Lloyd's.</td></tr>
<tr><td>Equalities impacts</td><td colspan="5">The measure applies to Lloyd's 'corporate bodies' only. No impacts on people with protected characteristics are expected.</td></tr>
<tr><td>Impact on business including civil society organisations</td><td colspan="5">Where processes for taking out stop-loss reinsurance need to be changed to factor in the change in the timing of the tax deduction, the cost of this change is expected to be negligible.</td></tr>
<tr><td>Operational impact (£m) (HMRC or other)</td><td colspan="5">The impact on HM Revenue and Customs is likely to be negligible. There will be training/familiarisation costs for a small number of specialists.</td></tr>
<tr><td>Other impacts</td><td colspan="5"><u>Small firms impact test:</u> The Government’s informal consultation included discussions with representatives of small business. The impact of the measure on these businesses is expected to be negligible

<u>Competition assessment:</u> A decision to take out stop-loss insurance is a commercial rather than a tax decision, and so the measure should not impact on insurers' ability to compete.

No other impacts are expected.</td></tr>
</table>

Monitoring and evaluation

HMRC has an established programme of liaison with the industry, which will capture issues around implementation and ongoing compliance and administrative costs. In addition, companies are required to prepare tax returns and computations which will provide data to inform any such monitoring and evaluation.

Further advice

If you have any questions about this change, please contact David Moran on 020 7147 2612 (email: david.moran@hmrc.gsi.gov.uk).

1 Corporate members of Lloyd's: stop-loss insurance and quota share contracts

(1) In section 225 of FA 1994 (corporate members of Lloyd's: stop-loss and quota share insurance), after subsection (3B) insert—

"(3C) Subsection (3D) applies to any premium which is payable by a corporate member under a stop-loss insurance taken out in respect of its underwriting business and in relation to which section 220(2)(a) does not apply.

(3D) The premium is to be treated for the purposes of the Corporation Tax Acts—

(a) as an amount that arises to the member directly from its membership of the syndicate or syndicates in relation to the activities of which the stop-loss insurance was taken out, and

(b) as if it were payable in the underwriting year in which the profits or losses arising to the member directly from its membership of the syndicate or syndicates concerned are declared.

(3E) If a premium is payable under a stop-loss insurance in respect of two or more underwriting years, the amount of the premium treated, as a result of subsection (3D)(b), as payable in each of those years is to be determined on a just and reasonable basis.

(3F) If—

(a) a corporate member enters into a quota share contract, and

(b) the main purpose, or one of the main purposes, of entering into it was to secure that amounts payable by the member under the contract were not dealt with on the basis set out in subsection (3G),

the contract is treated for the purposes of subsections (3C) to (3E) as if it were a stop-loss insurance (and, accordingly, the amounts payable under it are treated for those purposes as premiums).

(3G) Amounts are dealt with on the basis set out in this subsection if they are treated as payable in the underwriting year in which the profits or losses arising to a corporate member directly from its membership of one or more syndicates are declared."

(2) The amendment made by this section has effect in relation to—

(a) any stop-loss insurance (as defined by section 230(1) of FA 1994) taken out on or after 6 December 2011, or

(b) any quota share contract (as defined by section 225(4) of FA 1994) entered into on or after that date.

EXPLANATORY NOTE

CORPORATE MEMBERS OF LLOYD'S: STOP-LOSS INSURANCE AND QUOTA SHARE CONTRACTS

SUMMARY

1. This clause introduces new rules for the taxation of premiums payable by corporate members of Lloyd's under stop-loss insurance. It also includes an anti-avoidance provision in respect of quota share contracts.

DETAILS OF THE CLAUSE

2. Subsection (1) inserts new subsections (3C) to (3G) into section 225 of Finance Act 1994 ('FA 1994').

3. New section 225(3C) provides that the tax treatment described in new section 225(3D) shall apply to any premium payable by a corporate member of Lloyd's in respect of that member's underwriting business which is not already taxed under the rules in section 220(2)(a) of FA 1994.

4. New section 225(3D) sets out the tax treatment for a premium which meets the description in new section 225(3C). The premium will be treated as if it were an amount that had arisen directly as a consequence of that member's membership of the syndicate or syndicates in respect of which the stop-loss insurance was taken out. In addition, it will be treated as if it were payable in the underwriting year in which the profits or losses of those activities are declared.

5. New section 225(3E) provides for the situation where a stop-loss insurance premium is payable in respect of two or more underwriting years. The premium payable in respect of each of those years for the purposes of new section 225(3D) must be determined on a just and reasonable basis.

6. New section 225(3F) sets out the tax treatment where a corporate member of Lloyd's enters into a quota share contract and the main purpose, or one of the main purposes, for entering into that contract was to avoid the tax treatment set out in new section 225(3G). In such a case, the contract will be treated as if it were a stop-loss insurance and any amounts payable under the contract will be treated as premiums. The deemed premiums will be taxed in accordance with new section 225(3D).

7. New section 225(3G) describes the tax treatment referred to in new section 225(3F), the attempted avoidance of which triggers the operation of new section 225(3F). The relevant tax treatment is that amounts are treated as payable in the underwriting year in which the profits or losses arising to a corporate member directly from its membership of one or more syndicates are declared.

8. Subsection (2) provides that the amendment made by this section applies to stop-loss insurance (as defined by section 230(1) of FA 1994) and quota share contracts (as defined by section 225(4) of FA 1994) taken out or entered into on or after 6 December 2011.

BACKGROUND NOTE

9. Following the Budget 2011 announcement, the Government has been consulting with Lloyd's and interested parties on proposals to amend the timing of the tax deduction for Lloyd's member-level stop-loss premiums.

10. Taking into account these discussions, the Government has decided to amend the timing of the tax deduction for all premiums payable by corporate members of Lloyd's in respect of member-level stop-loss insurance taken out on or after 6 December. The legislation will align the timing of the tax deduction for the premiums with the recognition of the profits to which they relate.

11. If you have any questions about this change, or comments on the draft legislation, please contact David Moran on 020 7147 2612 (email: david.moran@hmrc.gsi.gov.uk).