

TR 93/5 - Income tax: foreign tax credit system - taxation of Australian resident members of Lloyd's of London

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Taxation Ruling

Income tax: foreign tax credit system - taxation of Australian resident members of Lloyd's of London

other Rulings on this topic

IT 2610 IT 2638

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This Ruling, to the extent that it is capable of being a 'public ruling' in terms of Part IVAAA of the Taxation Administration Act 1953, is a public ruling for the purposes of that Part. Taxation Ruling TR 92/1 explains when a Ruling is a public ruling and how it is binding on the Commissioner.

What this Ruling is about

Taxation Rulings Nos IT 2610 and 2638 clarified the operation of the foreign tax credit system (FTCS) as it applied to Australian resident members of Lloyd's of London (Lloyd's Names) for the income years 1987-88 to 1989-90.

2. This Ruling clarifies the operation of those rules as they apply to the income years 1990-91 and 1991-92. In addition, this Ruling sets out our response to representations that have been made for clarification of certain other issues in relation to the taxation of Lloyd's income of resident Lloyd's Names. This Ruling should be read along with Taxation Rulings Nos IT 2610 and 2638.

Ruling

3. The underwriting income, including the investment income and gains from the premiums trust fund, is treated as derived by the Lloyd's Name upon the income becoming available to the Name. The date upon the letter or document which notifies the Name of the availability of this income (ie, that issued by the Name's Agent) is taken to be the date of derivation of the income. A corresponding rule applies to loss notifications.

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4. The income and gains from the Lloyd's Deposit, Personal Reserve and Special Reserve of the Lloyd's Name, for a United Kingdom income year, are to be included in assessable income for Australian tax purposes in the same income year in which the underwriting profits that are taken into account for that United Kingdom income year are subjected to tax in Australia. Any losses in relation to assets that formed part of the Deposit or Reserve are to be deducted from the income and gains on the same basis. Any income exempt from United Kingdom income tax should be included in assessable income in the year of income in which it is derived.

5. The underwriting profits or losses of a Lloyd's Name to be included in his or her assessable income are to be based on the amounts determined for United Kingdom tax purposes, as shown on the Inland Revenue forms LL9 and LL200 and any other relevant United Kingdom Inland Revenue determinations. The reference to the amount determined for United Kingdom tax purposes is a reference to the amount before any adjustment for the accrued income or deductions included in this amount that are needed to take account of the special rules that apply in the United Kingdom to non United Kingdom residents. These amounts are to be adjusted by:

- adding back foreign taxes, including United States and Canadian taxes, allowed as deductions in the United Kingdom computation of profits;
- adding back any amounts that are not allowable deductions for Australian tax purposes;
- including in assessable income any amounts that are assessable under Australian tax law but not included in calculating the profits shown in forms LL9 and LL200; and
- deducting any expenses that are allowable deductions for Australian tax purposes but have not been taken into account in calculating the profits shown in forms LL9 and LL200.

6. The Lloyd's underwriting profits and the income and profits (excluding dividend income) from the Lloyd's Deposit, Personal Reserves and the Special Reserves are treated as business profits from Lloyd's business. They are taken to belong to the class of business profits for the purposes of the calculation of foreign tax credits and the application of the foreign loss quarantining provisions. Any dividend income from the Lloyd's Deposit, Personal Reserves and the Special Reserves will form part of passive income for foreign tax credit purposes and be modified passive income for purposes of the application of the foreign loss quarantining provisions.

7. The profits on the disposal of assets held as part of the Lloyd's Deposit, Personal Reserve or Special Reserve are to be calculated by

reference to their cost and the proceeds on disposal. Where an asset was introduced by a Name into his or her Lloyd's business subsequent to its purchase, the market value of that asset at the time of transfer rather than the original purchase cost will be taken into account in computing the income from Lloyd's.

8. Legal expenses incurred in seeking compensation from general or underwriting agents for losses incurred are allowable deductions for the income year in which the legal expenses are incurred. Any recoveries made will be included in assessable income of the income year in which they are derived.

9. Recoveries and compensation received for prior year losses are to be included in the assessable income for the income year in which they are derived.

10. Premiums paid by a Lloyd's Name in respect of the Lloyd's Contingency Estate Protection Plan are not allowable deductions.

11. A foreign tax credit adjustment in relation to the option available for United Kingdom tax purposes to carry back business losses will arise for Australian taxation purposes only where a resident Lloyd's Name elects to carry back a Lloyd's loss to prior income years. Where a Name has made that election, the foreign tax credit previously allowed for Australian tax purposes has to be revised taking into account the refund of United Kingdom tax. However, the Australian tax treatment of the loss will not be affected by the election.

12. The normal rules for the lodgment of returns will apply. However, where final forms LL9 and LL200 have not been issued by the United Kingdom Inland Revenue by the time the return has to be made, the return may be made on the basis of the provisional LL9 form issued by the United Kingdom Inland Revenue. The return must be amended when the final forms are available. However, no penalty or interest will accrue as a result of the adjustment.

Date of effect

13. This Ruling will apply for the income years 1990-91 and 1991-92. However, it does not apply to taxpayers who have agreed to a settlement for those income years in relation to matters dealt with in this Ruling.

Explanations

Underwriting account income

14. The underwriting account income, including the investment income and gains from the premiums trust fund, are treated as derived by the Lloyd's Name when the result for the underwriting year becomes available to the Name by being finalised and distributed. The date of derivation of the income is taken to be the date of the distribution statement or other advice issued by the Name's Agent which notifies the Name of the availability of the income.

15. This treatment of the underwriting account income has regard to the mandatory United Kingdom requirements regarding the creation and operation of the Premiums Trust Fund and the Lloyd's standard accounting period.

16. Similarly, a loss from carrying on a business at Lloyd's in respect of a year of account will be treated as incurred by a Lloyd's Name in the year of income in which the results for that year of account are finalised and the Name receives a notification from his or her agent of the loss. The loss is treated as incurred on the date shown on that notification.

Income from Lloyd's Deposit, Personal Reserves and Special Reserves

17. The income from the Lloyd's Deposit, Personal Reserve and Special Reserves of the Lloyd's Name is included, for United Kingdom tax purposes, in the income year in which that income is derived by the Name. The income of that income year will also include the underwriting results of the Lloyd's underwriting year that ended in that income year. To facilitate the computation of the foreign tax credit, both categories of income will be included in assessable income for Australian tax purposes in the income year in which the underwriting result is included in assessable income. Any income which is exempt from United Kingdom income tax should be included in assessable income in the year of income in which it is derived.

Amount of the underwriting income

18. For Australian income tax purposes underwriting profits or losses of a Lloyd's Name are to be based on the amount determined for United Kingdom tax purposes, as shown on the Inland Revenue forms LL9 and LL200 and any other relevant United Kingdom Inland Revenue determination.

19. However, the net profit or loss shown on these forms has to be adjusted by:

- adding back the amount of any foreign taxes, including United States and Canadian taxes, paid that have been allowed as a deduction for United Kingdom tax purposes;
- adding back any amounts that are not allowable deductions under Australian tax law;
- including any amounts that are assessable income under Australian tax law but are not included in calculating income in forms LL9 and LL200, such as income which is exempt from United Kingdom tax; and
- deducting any expenses that are allowable deductions for Australian tax purposes but have not been taken into account in calculating the profits in forms LL9 and LL200.

Nature of the underwriting income

20. The result of an underwriting account generally consists of the sum of the earned premiums and the income and profits from the investment of the premiums trust fund less the sum of the claims and expenses incurred in deriving the income and gains. All of this income will be treated as business profits from Lloyd's underwriting. The provisions of Part IIIA (capital gains and capital losses) of the *Income Tax Assessment Act 1936* (ITAA) will not apply in respect of these gains.

21. A Name's Lloyd's Deposit, Personal Reserve and Special Reserve Fund are considered to be funds employed in the course of carrying on the Name's Lloyd's underwriting business. The income and gains from these deposits and reserves (other than dividend income) are to be treated as part of the business profits of the Lloyd's underwriting business carried on by the Name.

22. All of the income and gains from the underwriting account and the income and gains (other than dividend income) from the funds at Lloyd's will be treated as business profits. They will accordingly constitute one class of income (ie business profits) for foreign tax credit purposes as well as for the purposes of the provisions relating to the quarantining of foreign losses under sections 79D and 160AFD. The dividend income will be passive income for foreign tax credit purposes and modified passive income for the purposes of quarantining of foreign losses.

Calculation of profits or losses on the disposal of assets held in the Lloyd's Deposit Account, Personal Reserves or Special Reserves

23. The question has been asked whether a different method of calculation of profits or losses will apply if a Lloyd's Name held the asset in one of the deposit or reserve accounts prior to the commencement of the FTCS. It has been submitted that only the

profits that accrued after the commencement of the FTCS should be included in assessable income as profits realised prior to the introduction of the FTCS would have been exempt from Australian tax had they been realised at that time.

24. Representations have also been made that a Lloyd's Name who becomes a resident of Australia should have to include in assessable income only the profits that accrued after the Name became a resident.

25. We do not agree with these submissions. The rules relating to the timing of the derivation of assessable income would have the effect that a profit or loss on sale arises on the disposal of the asset. This profit or loss is calculated, in a continuing business, as the difference between the cost of the asset and the proceeds on disposal.

Legal expenses incurred in seeking compensation from general or underwriting agents for losses incurred

26. Representations have been made by some Lloyd's Names that a deduction should be allowable in computing taxable income for legal expenses incurred by the Names in seeking compensation from their Lloyd's agent for losses incurred by the Names.

27. We agree that these expenses are an allowable deduction for the income year in which they are incurred. Correspondingly, any recoveries made are to be included in assessable income when the recoveries are derived.

Compensation received by Names in respect of Lloyd's insurance losses

28. Representations have been made that compensation or recoveries received by a Name in relation to losses incurred prior to the commencement of the FTCS should be excluded from the Name's assessable income. This claim is based on the fact that those losses had not been allowed as deductions from the Name's assessable income in those years.

29. This claim is not accepted. Prior to the introduction of the FTCS, losses from the business of Lloyd's were not generally allowable as deductions as the expenses that gave rise to the losses were not incurred in deriving assessable income. However, in a continuing business, recoveries or compensation received in respect of prior losses would be included in assessable income. This treatment cannot be varied on the ground that the losses were not deductible in the income years in which they were incurred.

30. However, it may be the case that the Name is required to recompense the Name's Lloyd's agent or another underwriting party in relation to the recoveries made by the Name. In these cases, the

expense will be an allowable deduction for the income year in which it is incurred.

Exchange rates for the translation of Lloyd's income

31. The following table shows the rates of exchange at which income from Lloyd's and some related amounts are to be converted into Australian currency.

- Underwriting account income	The currency rate applicable on the day of distribution as indicated in the distribution statement prepared by the Name's Underwriting Agent
- Underwriting account loss	The currency rate applicable on the date of the distribution statement prepared by the Name's Underwriting Agent that notified the Name of the amount of the loss or, where the Name remitted funds to Lloyd's in relation to that loss on calls made prior to that day, the currency rate applicable to that remittance.
- Income not shown on forms LL9 and LL200	Average rate of exchange for the income year in which the income was paid or credited or the actual rate on the day the income was paid or credited
- United Kingdom and foreign taxes that relate to the categories of income listed above	Rate used to translate the relevant income
- United Kingdom higher rate tax	Rate prevailing on the date of payment of the tax

Premiums paid in respect of the Lloyd's Contingency Estate Protection Plan

32. Representations have been made that a premium paid in respect of the Lloyd's Contingency Estate Protection Plan (EPP) is an allowable deduction in computing the assessable income from Lloyd's business. This claim is not accepted. The expense is not an allowable deduction as it is not considered to be incurred in deriving the Name's

assessable income or in carrying on business for the purpose of deriving assessable income.

Carry-back of losses under the United Kingdom taxation rules

33. Under the taxation laws of the United Kingdom, a business loss incurred in an income year can be carried back to reduce income of the three preceding income years. However, such a loss carry-back would reduce the United Kingdom income tax payable in those years. Consequently, the foreign tax credit allowed for those taxes would be correspondingly reduced with the effect that the Australian tax payable would be increased to the same extent.

34. Representations have been made that a foreign tax credit allowed for the United Kingdom taxes paid in those years should not be reduced solely because of the option available to the Lloyd's Name to carry-back losses under the United Kingdom tax laws. This proposition is accepted. The foreign tax credit will be reduced only where the Lloyd's Name avails himself or herself of the election to carry-back the losses for United Kingdom tax purposes.

Maintenance of accounts in Pounds Sterling after 1 July 1990

35. As an alternative to the method set out in paragraph 31 for the conversion of a loss, a net loss incurred by a Lloyd's Name from Lloyd's operations may be accounted for in Pounds Sterling for loss carry-forward purposes. In the income year in which the loss is fully recouped, the balance of the Sterling denominated Lloyd's income for the income year should be returned for income tax purposes converted at the exchange rate determined in the way set out in paragraph 31.

Securities transferred to and from Reserves and Deposits

36. If the securities continue to be owned by the Lloyd's Name, the transfer of the securities from one Personal Reserve to another or from the Lloyd's Deposit account to a Personal Reserve account will not give rise to recognition of income. However, where there is a disposal of securities, the profit or loss on disposal should be calculated as explained in paragraph 7.

Lodgment and basis of returns for the income years 1990-91 and 1991-92

37. Lloyd's Names were required to lodge their returns for the 1990-91 income year in accordance with the rules applicable under ITAA. In the event final LL9 and LL200 forms were not issued by the United Kingdom Inland Revenue by the date the Name's return for that year was due for lodgment, Names were authorised to lodge for that year using the provisional LL9 form issued by the Inland Revenue.

38. The authorisation was given on the basis that the returns had to be amended once the final LL9 and LL200 forms were issued by the United Kingdom Inland Revenue and that no penalty or interest was to accrue to the Names as a result of any adjustments that became necessary as a result of those amendments.

39. The lodgement rules that applied to the 1990-91 income year apply for the 1991-92 income year as well.

Commissioner of Taxation

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