

## **LOSS-BUYING: draft legislation and explanatory note**

Legislation will be in Finance Bill 2007 designed to prevent companies acquiring tax losses from corporate members of Lloyd's with which they have had no previous economic relationship and which are leaving the insurance market. It will be effective from today (21 March 2007).

Draft clauses and a draft explanatory note are below. Further information can be obtained from

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### **DRAFT LEGISLATION**

(1) In FA 1994, after section 227 insert—

#### **“227A Restriction of group relief**

(1) Losses of the last active underwriting year of a corporate member are not eligible for surrender by the corporate member as group relief to another company unless the group-relief continuity condition is satisfied.

(2) In this section “last active underwriting year”, in relation to a corporate member, means—

(a) if the corporate member writes insurance business in only one underwriting year, that underwriting year, and

(b) otherwise, the last underwriting year in which the corporate member writes insurance business.

(3) Where in an underwriting year—

(a) the corporate member writes an amount of insurance business which is insignificant when compared with that written by it in the preceding underwriting year, or

(b) the only insurance business written by the corporate member consists of the acceptance of reinsurance to close premiums,

the underwriting year is not to be regarded for the purposes of subsection (2)(b) above as an underwriting year in which the corporate member writes insurance business.

(4) In subsection (3)(b) above “reinsurance to close premium” means a premium under a contract in pursuance of which, in accordance with the rules or practice of Lloyd's, one underwriting member agrees with another to meet liabilities arising from the latter's underwriting business in an underwriting year so that the accounts of the business for that year may be closed.

- (5) The group-relief continuity condition is satisfied if the corporate member (as the surrendering company) and the other company (as the claimant company) meet the conditions in section 402(2) or (3) of the Taxes Act 1988 throughout the period—
- (a) beginning with the last day of the last active underwriting year of the corporate member, and
  - (b) ending with the first day of the first underwriting year in which losses of the last active underwriting year are declared.”
- (2) The amendment made by subsection (1) has effect in relation to any case where the corporate member (as the surrendering company) and the other company (as the claimant company) first meet the conditions in section 402(2) or (3) of ICTA on or after 21st March 2007.

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## DRAFT EXPLANATORY NOTE

### SUMMARY

1. This clause introduces a new narrowly targeted rule designed to prevent companies acquiring tax losses from corporate members of Lloyd's with which they have had no previous economic relationship and which are leaving the insurance market. Special accounting rules used at Lloyd's exceptionally permit group relationships to be changed before losses already determined become tax effective. The rule will extend the period during which the claimant and surrendering companies must satisfy relationship tests. It will apply where the necessary relationship is first established on or after 21 March 2007.

### DETAILS OF THE CLAUSE

2. Subsection (1) of Clause XX inserts a new section 227A into Chapter 5 of Part 4 of the Finance Act (FA) 1994, the Chapter dealing with special tax rules for corporate members of the Lloyd's insurance market.
3. Subsection (1) of section 227A provides that losses of the last active underwriting year of a corporate member may be surrendered to another company under the group relief provisions only where a condition called the group-relief continuity condition is satisfied.
4. Subsection (2) of section 227A defines "last active underwriting year" of a corporate member as the last underwriting (calendar) year in which it writes insurance business (or the year in which it writes business if there is only one).
5. Subsection (3) of section 227A refines the meaning of last active underwriting year. Sub-paragraph (a) prevents manipulation by ignoring insurance business written in an underwriting year if the amount of the business underwritten is insignificant compared with business written in the previous underwriting year. Sub-paragraph (b) recognises that the acceptance of a reinsurance to close premium by a

corporate member takes place after the underwriting year to which it relates and consequently disregards it in determining whether the year in which it is accepted is a final underwriting year.

6. Subsection (4) of section 227A provides the definition of reinsurance to close premium. It is paid, in accordance with the rules and practice of Lloyd's, under an agreement which enables the accounts of a member for an underwriting year to be closed through the reinsurance of outstanding liabilities of that year with another underwriting member.
7. Subsection (5) of section 227A defines the group-relief continuity condition. It is satisfied if the corporate member (as surrendering company) and another company (as claimant) satisfy the relationship conditions for group and consortium claims throughout a period defined by sub-paragraphs (a) and (b). This runs from the last day of the last active underwriting year of the corporate member to the first day of the first underwriting year in which losses of the last active underwriting year are declared.
8. Subsection (2) of clause XX is the commencement provision. The new section applies to any case where the corporate member and claimant company first meet the necessary group or consortium claim relationship conditions on or after 21 March 2007.

#### **BACKGROUND NOTE**

9. The group relief code is set out at Chapter 4 of Part 10 of the Income and Corporation Taxes Act 1988 (ICTA). The code allows one company which has made a trading loss or other amount eligible for relief to surrender that loss to another company with which is in a relationship defined at section 402(2) of ICTA (for group claims) or section 402(3) (for consortium claims).
10. The claimant and surrendering companies must fulfil the relationship conditions throughout the period for which the claim is made. Trading losses and other amounts may only be surrendered "sideways". They cannot be carried forward or back and surrendered and there is a provision that brings the qualifying relationship to an end as soon as arrangements are made for the qualifying relationship to change. The aim of this and other provisions within Chapter 10 of Part 4 of ICTA is to limit surrenders to those taking place between companies which are in a genuine economic and commercial relationship.
11. This aim is undermined by the special "three year" accounting rule applied to the profits and losses of Lloyd's syndicates. This is a survival of traditional insurance "fund" accounting, which aims for more accurate reporting at the expense of delay. Under this system, the results of business written or "incepted" in year 1 are not declared until year 4, after 36 months have passed from the beginning of the underwriting year of inception.
12. The practical effect of this is that the group relationship could be changed, say towards the end of year 3. By this time, the results of underwriting in year 1 are likely to be known with considerable accuracy. If they reflect significant losses, and the corporate member has decided to withdraw from the market, arrangements can

be made before the commencement of year 4, the year in which the losses become tax effective, for the corporate member to join a profitable group interested only in acquiring the losses. This is a scheme disclosed under the rules of Part 7 of FA 2004 ("Disclosure of Tax Avoidance Schemes").

13. It is unlikely that a profitable group not concerned with insurance would acquire a corporate member in these circumstances unless it had ceased to write new business, as it would not wish the exposure to further losses that might result and could run into problems with the regulatory authority.
14. The new narrowly targeted provision seeks to strike a balance between the purchase of losses by a group not commercially or economically connected with the loss-making corporate member and the facilitation of relief where there is an economic restructuring. It applies from 21 March 2007 because any later commencement date (for example, the date that Finance Bill 2007 receives Royal Assent) would enable companies looking to acquire tax losses from corporate members to take steps to forestall the effect of this tightly targeted measure, which would undermine its objective.