SUMMARY OF THE CHANGES TO THE FOREIGN LOSS QUARANTINING RULES AND HOW THEY AFFECT AUSTRALIAN NAMES AT LLOYD'S OF LONDON

The changes to the foreign loss quarantining rules which were announced in the 2005 budget became law in September 2007 and came into operation on the 1st July 2008

This is a summary of the changes and how they might affect Australian underwriters at Lloyd's of London, particularly those with unused carried forward losses. This is only a general summary and Names should get specific advice relating to their own personal circumstances.

PREVIOUS RULES

Under the previous system, foreign losses were quarantined from domestic income, to prevent them being used by taxpayer's to lower the rate of Australian tax paid. Foreign losses could only be offset against foreign sourced income of the same class. In the event that there were excess foreign losses these were able to be carried forward and offset against any future foreign income of the same class. There was no time limit on carrying forward these losses.

Foreign tax credits could only be used against foreign income. If they were not able to be utilised they could be carried forward, however there was a time limit of 5 years after which time the foreign tax credits expired.

AUSTRALIAN TAX RULINGS REGARDING LLOYD'S

There were originally several Australian Tax Rulings which deal specifically with how the foreign loss quarantining and foreign tax credit system applied to Australian resident Names at Lloyd's. These were IT 2610, IT 2168, TR 93/5, TR 93/41. These Rulings were withdrawn effective the 28th February 2003, however the Tax Office stated that Names could continue dealing with their tax affairs along the lines of the 4 rulings to the extent that doing so does not conflict with TR 2005/18

Amongst other things, these rulings stated:

Lloyd's income is foreign sourced
To the extent that Names derive assessable income from carrying on a business at Lloyd's, that income will have a foreign source and therefore losses will be subject to the Foreign Loss Quarantining rules.(IT 2610 para 21)

Date of derivation of income
The income derived from underwriting at Lloyd's is to be treated as derived upon the income becoming available to the Name. Accordingly, the date upon the letter/document which notifies the Name of the availability of this income will be taken to be the date of derivation for tax purposes.(IT 2610 para 4)

TR 2005/18 Names Losses at Lloyd's are subject to the foreign loss quarantining rules.
In 2005 The Tax Office introduced a new tax ruling which confirmed the Tax Office view that Lloyd's losses were subject to the foreign loss quarantining rules.

REMOVAL OF FOREIGN LOSS QUARANTINING RULES

The Federal Treasurer forecast in the budget in May 2005 that he would remove the quarantining provisions for foreign losses, so that foreign losses would be able to be offset against domestic income in some circumstances.

The Legislation passed successfully through Parliament and received Royal Assent on the 24th September 2007, and came into effect from the 1st July 2008.

This means that from the 2009 Financial Year onwards Names will be able to offset any losses at Lloyd's against their Australian income, effectively allowing a tax deduction in Australia for losses at Lloyd's.

TRANSITIONAL PROVISIONS – CARRIED FORWARD LOSSES AS AT 30TH JUNE 2008

Convertible Foreign Loss

The transitional provisions for the treatment of Carried Forward Foreign Losses are as follows:

The 2009 Financial Year becomes the "Commencement Year".

The Taxpayer is to convert their carried forward loss to a "Convertible Foreign Loss"

The Convertible Foreign Loss is calculated as follows:

- The Sum of the unrecouped foreign losses from any of the most recent 10 years before the Commencement Year, being the financial years from 1999 to 2008,

- Reduced by any losses which were incurred in gaining or producing income that was not assessable;

  And

- Reduced by 50% of the losses for the years other than the most recent 7 years, i.e. reduced by 50% of any unrecouped losses from 1999, 2000 & 2001.

Any other carried forward foreign losses are extinguished.

If a Name normally receives the Notification of their results in July e.g for the 2004 Year of Account Notification is received in July 2007, and IT 2610 is followed, the Convertible Foreign Loss would be 100% of any unrecouped losses from the 1998 Year of Account to the 2004 Year of Account and 50% of any unrecouped losses from the 1995, 1996 & 1997 Years of Account.

Deductibility

The calculation of the convertible foreign losses results in a "Loss Parcel". The rules for deductibility of the Tax Loss are as follows:

- If the Loss Parcel is $10,000 or less it is deductible in the commencement year.ie. 2009.

- If the Tax Loss is more than $10,000 the taxpayer has the choice between:

    - claiming $10,000 in the commencement year, and losing the rest, or

    - claiming one-fifth of the losses in each of the 5 years from 2009 onwards.

If the taxpayer has insufficient income in one year to offset against the losses, they can be carried forward to the next year.

If a taxpayer ends up not having to pay for a loss the deduction is lost under the debt forgiveness rules.

FOREIGN TAX CREDITS

A tax offset is allowed for eligible foreign income tax paid.

There is no carry-forward of excess foreign tax credits. An exception applies to excess foreign tax pertaining to the five years prior to commencement of the new rules. The 5 year rule still applies to these credits.

ISSUES PARTICULAR TO AUSTRALIAN NAMES AT LLOYD'S OF LONDON

Lloyd's income is assessable income for Australian resident taxpayers, so there is no need to reduce the losses in this regard.

Some Names may have significant Lloyd's income in the 2009 or 2010 years which will outweigh the deductions allowable under the new rules, when compared to the use of their Carried Forward Losses under the old rules. Names effected in this way should consider whether or not the Notification date is the best date for determining the timing of their Lloyd's income. A private ruling may be required to ascertain whether this is possible or not.

Significant tax planning may be required taking into account a taxpayer's total financial situation.

DISCLAIMER

Please note that this summary is general in nature and taxpayer's should get professional advice to take their particular circumstances and history into account.

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