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CCP/PT

Treasury Chambers, Parliament Street, SW1P 3AG

B H Potter Esq
PS/Prime Minister
10 Downing Street
LONDON
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29 June 1990

Dear Barry,

THE BERMUDA PROTECTION AND INDEMNITY (P&I) ASSOCIATIONS

You wrote to Julie McClatchey at the Inland Revenue on 30 May about some tax concerns of the Bermuda P&I Association which have come to the Prime Minister's attention. The Financial Secretary has been in correspondence with the Associations (less formally, "Clubs") for some time now.

The Clubs' tax position has recently been under enquiry, and the Revenue's present view is that the Clubs should be charged here, as they have not been hitherto, on profits of business carried on through a UK agency. But the Financial Secretary understands that this is not a change of practice on the Revenue's part, but the result of a re-evaluation of the Clubs' position prompted by the emergence of new facts.

The background is that the Clubs, originally UK-based, have been Bermuda-resident for some time now, but have continued to carry on much of their day-to-day activity through representatives here. Following recent developments in insurance case law, the Clubs thought it appropriate to seek authorisation of the DTI to carry on insurance business here, and this in turn drew the Revenue's attention to their activity here and its possible tax implications.

The Clubs' advisers have put it to the Financial Secretary, as they have to the Prime Minister, that a UK tax charge would put jobs and revenues here at risk. The Financial Secretary understands, however, that the Clubs enjoy substantial commercial advantages from their representation here, as do a number of other Clubs which operate in a comparable way. He also gathers that the Revenue have indicated a willingness to settle on the basis of a charge which is quite modest in the context of the Clubs' affairs as a whole, and which has proved acceptable to the other Clubs.



The Financial Secretary would not discount altogether the net risk of adverse economic effects. But he judges it to be outweighed by the substantial disadvantages of amending the Finance Bill as the Clubs themselves propose. He has seen the specific words the Clubs' advisers have in mind, and he finds them very obviously ad hoc, designed to exempt a particular small group of potential taxpayers without tackling any evident mischief. Quite apart from the immediate loss of yield, and the rise of manipulation that might be opened up, the Financial Secretary would foresee a very unwelcome encouragement for other concerns carrying on internationally-mobile activity here to press for a similar exemption.

He has, however, suggested to the Clubs a possible alternative change in the law which would not exempt them altogether, but would bring the UK tax charge more securely into line with the commercial reality of their business. General insurance business is taxed, as a rule, on the overall balance of profit from underwriting and from investing premiums and reserves. For the sort of business the Clubs do, the result is commonly an underwriting loss offsetting and investment profit, with only the net amount being chargeable. In the case of mutual concerns like the Clubs, however, case law requires that only the investment profits are charged, disregarding any underwriting loss. Although the Revenue have taken this aspect into account in framing a suitable basis for an agreed settlement, the Financial Secretary feels that the Clubs may see attraction in amendments on the face of the legislation to ensure that the charge takes account of both their underwriting and investment activity.

The Financial Secretary has not at this stage offered any commitment to amend the law to this effect, and has indicated that no action is to be expected in the remaining few weeks of the Finance Bill's passage. But he feels that his suggestion is a constructive one which may well seem to the Clubs an appropriate response to their concerns.

Yours sincerely,

S J FLANAGAN
Private Secretary

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