

THE SURPLUS LINE ASSOCIATION
OF CALIFORNIA

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A. L. LATHROP
MANAGER
A. B. HERRICK
ASSISTANT MANAGER

December 26, 1968

No. 293

BULLETIN TO ALL MEMBERS:

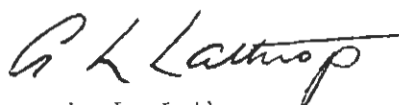
FEDERAL TAX ON LLOYDS WRITINGS.

Supplementing our Bulletin No. 290, our Executive Committee has requested that the attached letter of the 21st November, 1968 from the Chairman of Lloyd's be sent to all members of the Association.

At the same time the Committee agreed that a letter should be sent to the Committee of Lloyd's to forcibly present the problems that will be faced by the members of the California Surplus Line Association. Copy of this letter is also attached.

You will be advised of further developments.

Very truly yours



A. L. Lathrop
Manager

ENCLS.

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LLOYD'S.

LIME STREET,

LONDON, E.C.3.

THE CHAIRMAN

OAT

21st November, 1968.

Dear Sir(s),

United States Federal Income Tax

Following the changes in the U.S./U.K. Double Tax Convention and United States Federal Income Tax law, agreement has now been reached between the taxation authorities of the United States and the United Kingdom on the basis of taxation of Lloyd's Underwriters in the United States. A formal closing agreement setting out the new basis was signed in Washington on 19th November, 1968, by Messrs. LeBoeuf, Lamb, Leiby & MacRae as General Counsel on behalf of Lloyd's Underwriters in the U.S.A.

Under this agreement, as from 1st January, 1968, Lloyd's Underwriters will be paying tax in the United States on a basis which is more in harmony with other insurers in the United States. This means that they will be assessed to Federal Income Tax on the profits of their United States business together with the investment income relating thereto, but they will cease to be liable to Federal Excise Tax. You will remember that you were advised of this possibility in a letter dated 28th December, 1967.

So far as United States Brokers are concerned the future position is very simple. All business in United States dollars received through United States Brokers comes within the charge to United States Federal Income Tax and no premium which comes within the charge to income tax is subject to excise tax. Thus neither situs of risk nor any other consideration is involved where a United States Broker handles the business.

The new assessment for income tax, beginning with the year 1968, will be a matter between Underwriters and the United States Internal Revenue Service, but it is clearly essential, in order to avoid double taxation, that excise tax should cease to be paid immediately on all business accepted by Lloyd's Underwriters through United States Brokers.

I am therefore seeking, on behalf of Lloyd's Underwriters, the help and co-operation of United States Brokers in stopping all further payments of excise tax at the earliest possible moment.

The National Office of the Internal Revenue Service may not yet have had time to notify their Field Offices of this changed basis of taxation, but they will do so in the very near future.

As the new taxation arrangements are back-dated to 1st January, 1968, a substantial refund of excise tax already paid in respect of premiums remitted by United States Brokers during the year 1968 is due. Arrangements will have to be made to obtain a refund of this excise tax, when it will be necessary for me to approach you again. At that time we will be very pleased to make available to you the services of Lloyd's General Counsel to help in any arrangement to simplify procedures. In the meantime no action should be taken in connection with this refund other than to ensure that the necessary records are available to facilitate the recovery in due course from the United States Internal Revenue Service.

I fully appreciate the inconvenience which will be caused to you and to your United States Broker connections in the initial stages of this change in taxation. However, I feel sure that I can rely on your understanding and co-operation and those of your American correspondents in overcoming these problems. May I suggest that you pass on the information contained in this letter to each of your United States Broker correspondents, so that they are fully advised and can take immediate action in stopping all further payments of excise tax.

Finally I would stress the urgency of this matter, since from now onwards every payment of excise tax on Lloyd's business by a United States Broker is an unnecessary burden and will need to be refunded later.

Yours faithfully,

Ralph Ince

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RODERIC G. SMART, CHAIRMAN

DECEMBER 20, 1968

COMMITTEE OF LLOYD'S
LIME STREET
LONDON E.C. 3
ENGLAND

DEAR SIR:

WE WERE RECENTLY VISITED BY MR. COLIN THOMAS OF YOUR ORGANIZATION, WHO, WITH MESSRS. KEITH BROWN AND DON GREEN OF LEBOEUF, LAMB, LEIBY & MACRAE ATTENDED AN EXECUTIVE COMMITTEE MEETING OF THE SURPLUS LINE ASSOCIATION OF CALIFORNIA. AT THIS MEETING THE CHANGE IN THE FEDERAL TAX POSITION AS IT APPLIES TO UNDERWRITERS AT LLOYD'S WAS DISCUSSED IN CONSIDERABLE DETAIL AND A NUMBER OF PROBLEMS THAT WILL ARISE IN CONNECTION WITH CALIFORNIA OPERATIONS WERE BROUGHT TO LIGHT.

AS YOU ARE DOUBTLESS AWARE, AT THE TIME THE PRESENT FEDERAL TAX LAWS WERE PUT INTO EFFECT ABOUT THIRTY YEARS AGO THE CALIFORNIA SURPLUS LINE ASSOCIATION ADOPTED A RULE THAT FEDERAL TAX SHOULD BE ADDED TO THE PREMIUMS - NOT INCLUDED IN THEM. IN THE SAME MANNER IT WAS STIPULATED THAT STATE TAXES AND STAMPING FEES SHOULD ALSO BE ADDED TO THE PREMIUM. OTHER PACIFIC COAST STATES FOLLOWED OUR EXAMPLE BUT FOR SOME REASON OR OTHER MR. WILLIAM B. MENDES, OF THE THEN DUNCAN & MOUNT ORGANIZATION, WAS OPPOSED TO APPLYING THIS METHOD IN ANY OF THE EASTERN STATES. WE COULD NEVER UNDERSTAND HIS ATTITUDE AS PEOPLE IN THIS COUNTRY ARE QUITE USED TO HAVING TAXES ADDED TO ITEMS THEY PURCHASE AND THESE TAXES ARE ACTUALLY ADDED TO THE PURCHASE PRICE - NOT HIDDEN IN IT. THERE ARE SALES TAXES ON MOST GOODS. EXCISE TAXES ARE ADDED ON CERTAIN LUXURY ITEMS AND A TAX IS ADDED TO THE PRICE OF AN AIRLINE OR RAILROAD TICKET.

THE RECOMMENDATION OF MR. MENDES PRODUCED A RATHER CONFUSED SITUATION AS IN THE PACIFIC COAST STATES BOTH FEDERAL AND STATE TAXES ON INSURANCES TRANSACTED WITH LLOYD'S THROUGH THE SURPLUS LINE ASSOCIATION WERE PAID BY THE ASSURED, WHILE IN THE OTHER STATES THE STATE TAX WAS PAID BY THE ASSURED BUT THE FEDERAL TAX BY UNDERWRITERS.

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AT THE TIME THE FEDERAL TAX REGULATIONS WERE PUT INTO EFFECT CERTAIN UNDERWRITERS STATED THAT IF THEY HAD TO PAY THE TAX THEY WERE GOING TO REDUCE COMMISSIONS ACCORDINGLY, AND UNDOUBTEDLY THIS WAS ONE OF THE PRINCIPAL REASONS THAT THE SURPLUS LINE ASSOCIATION TOOK THE ACTION THEY DID IN STIPULATING THAT THE TAX BE PAID BY THE ASSURED. HOWEVER, FROM A PRACTICAL STANDPOINT IN MOST CASES UNDERWRITERS ENDED UP PAYING THE SAME RATES OF COMMISSION IRRESPECTIVE OF WHETHER THE TAX WAS PAID BY THEM OR BY THE ASSURED. IN EFFECT THEN UNDERWRITERS SAVED A CONSIDERABLE AMOUNT OF MONEY ON THE BUSINESS WRITTEN THROUGH THE FAR WESTERN STATES. FROM 1939 UNTIL 1967 INCLUSIVE PREMIUMS AMOUNTING TO APPROXIMATELY \$475,000,000 WERE DECLARED THROUGH THE SURPLUS LINE ASSOCIATION OF CALIFORNIA. MORE THAN TWO THIRDS OF THIS PREMIUM WAS ON INSURANCE TRANSACTED WITH UNDERWRITERS AT LLOYD'S. ABOUT 7% OF THE FIGURE WAS FOR ACCIDENT AND HEALTH INSURANCE WHERE ONLY 1% FEDERAL TAX WAS PAYABLE. AS A ROUGH ESTIMATE, HOWEVER, IT CAN BE SEEN THAT THE UNDERWRITERS SAVED ABOUT \$12,000,000 IN TAXES ON CALIFORNIA BUSINESS. WE WONDER HOW MUCH THEY WOULD HAVE SAVED IF THEY HAD APPLIED THE CALIFORNIA REGULATION TO ALL OTHER STATES!

AT THE RECENT EXECUTIVE COMMITTEE MEETING WE WERE TOLD THAT FEDERAL TAX IS NO LONGER PAYABLE BY UNDERWRITERS AT LLOYD'S. AS RESPECTS THE FUTURE IT IS QUITE SIMPLE - WE JUST STOP CHARGING FEDERAL TAX. HOWEVER, WE ARE ALSO TOLD THAT THIS RULING IS TO APPLY BACK TO JANUARY 1, 1968, AND ON ALL TRANSACTIONS ENTERED INTO SUBSEQUENT TO THAT DATE THE FEDERAL TAX IS TO BE REFUNDED. IF IT IS TO BE REFUNDED IN CALIFORNIA IT WILL NOT GO BACK TO UNDERWRITERS - IT HAS TO GO BACK TO THE ASSURED. THIS MEANS THAT EVERY SINGLE TRANSACTION ENTERED INTO WILL HAVE TO BE CHECKED TO FIND OUT WHAT PORTION, IF ANY, WAS PLACED OTHER THAN WITH UNDERWRITERS AT LLOYD'S AND THE AMOUNT OF FEDERAL TAX APPLICABLE TO THE LLOYD'S PORTION FIGURED OUT ON EACH OF THESE TRANSACTIONS. PRESUMABLY THEN SEPARATE LETTERS WILL HAVE TO BE WRITTEN AND SEPARATE DRAFTS ISSUED TO EACH SEPARATE ASSURED - THE EXPENSE WILL BE ENORMOUS.

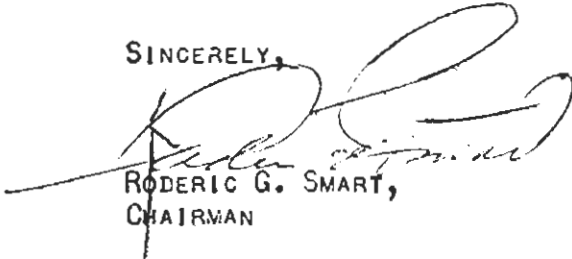
WE, AS AN ASSOCIATION, FEEL EXTREMELY CHAGRINED THAT UNDERWRITERS DID NOT SEE FIT TO CONSULT US A LONG TIME AGO. WE THOROUGHLY AGREE THEY SHOULD NOT HAVE TO PAY FEDERAL TAX IF THEY ARE GOING TO BE SUBJECT TO AMERICAN INCOME TAX, BUT IF THEY HAD APPLIED THE SAME METHOD OF HANDLING THE TAX IN ALL STATES AS WE HAD IN CALIFORNIA THE PROBLEM WOULD HAVE BEEN SOLVED. IT SHOULD BE POINTED OUT THAT, WHILE THERE WAS SOME GENERAL KNOWLEDGE TO THE EFFECT THAT UNDERWRITERS AT LLOYD'S WERE WORKING IN WASHINGTON TO SECURE FEDERAL TAX RELIEF, THERE HAD NEVER BEEN ANY OFFICIAL COMMUNICATION SENT TO THE SURPLUS LINE ASSOCIATION OF CALIFORNIA ON THIS SUBJECT. AS AN ASSOCIATION WE HAVE TRIED TO WORK CLOSELY WITH UNDERWRITERS AT LLOYD'S SINCE OUR FORMATION MORE THAN THIRTY YEARS AGO. IT IS THEN VERY DIFFICULT FOR US TO UNDERSTAND HOW UNDERWRITERS AT LLOYD'S COULD, IN EFFECT, PRESENT US WITH A FACT ACCOMPLI ON THIS TAX SITUATION WITHOUT EVER PERMITTING US TO DISCUSS WITH THEM THE PROBLEMS INVOLVED.

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WE FEEL THIS ACTION ON THE PART OF UNDERWRITERS HAS PLACED AN EXTREMELY UNFAIR BURDEN ON THE CALIFORNIA SURPLUS LINE BROKERS. IN PARTICULAR IT PLACES A CONSIDERABLE HARDSHIP ON THE SMALL BROKER HANDLING NUMEROUS SMALL ACCOUNTS. SOME ASPECTS OF THE SITUATION ARE STILL VERY MUCH UP IN THE AIR AND IT MAY BE A CONSIDERABLE TIME BEFORE DEFINITE RULINGS COME OUT OF WASHINGTON. WHATEVER THE FINAL OUTCOME, IT IS OBVIOUS THAT COLLECTING RETURN TAX AND REMITTING IT TO INDIVIDUAL ASSUREDS WILL BE A VERY EXPENSIVE PROBLEM FOR EACH SURPLUS LINE BROKER. WE FEEL JUSTIFIED IN ASKING THAT UNDERWRITERS WORK OUT SOME METHOD OF REIMBURSEMENT TO THE SURPLUS LINE BROKER. HOW THIS COULD BEST BE ACHIEVED IS A MATTER FOR DISCUSSION, BUT IT CERTAINLY SEEMS THAT UNDERWRITERS SHOULD BEAR THE RESPONSIBILITY FOR A SITUATION THEY HAVE CREATED WITHOUT ANY PRIOR CONSULTATION WITH THE SURPLUS LINE ASSOCIATION OF CALIFORNIA.

SINCERELY,



RODERIC G. SMART,
CHAIRMAN

RGS:LS