UNDERWRITING COMMISSIONS AND PENSION FUNDS

There has, for many years, been considerable misunderstanding amongst those administering Pension Funds concerning the liability of underwriting commissions for income tax. Some have held that since approved Pension Funds are "free of tax" these underwriting commissions would not be taxable. The position is, of course, that such Funds are not exempt from all tax but that "the income derived from investments shall be exempt from income tax" (Section 379, Income Tax Act 1952). There seems to be no doubt that underwriting commission is taxable under Schedule D, Case VI, (Section 135, 1952 Act).

Others who had appreciated that underwriting commission might be liable for tax had the erroneous impression that if underwriting commission is utilised to write down the cost of -

(a) any Stock with which the underwriter is left under the underwriting, or

(b) any Stock which may be secured as a result of an application for some of the Stock underwritten, or

(c) any of the same Stock purchased when dealings commence,

then such underwriting commission escapes tax. This view may have come about because if this practice is adopted, then no item of underwriting commission appears in the Fund's Accounts and no question therefore arises in the mind of the Inspector of Taxes that there may be a tax liability on this count. The fact that Inspectors of Taxes have not raised the point is of course not evidence that there is no tax liability. In many cases there has appeared for many years in the Accounts a small item representing underwriting commission on those Stocks in which the underwriter has been entirely relieved and yet in which the Fund has not acquired a holding under (b) and (c) above, and from the cost of which the underwriting commission would be written off. The Inspector has no doubt taken note of these items and perhaps, not appreciating that they may represent only a very small part of the underwriting activities, has considered them not of sufficient size to warrant making an assessment.

It seems clear that only the commission in respect of that part of an underwriting commitment from which the underwriter is relieved by public subscription is liable for tax, and there is, moreover, a concession which provides for a possible setoff against such taxable underwriting commission in the following way. If within 12 months from the date of allotment Stock which the Underwriter has had to take up is sold, and after allowing for the writing down of the cost by the amount of that portion of the underwriting commission applicable to that Stock the sale shows a loss, then such loss can be set off against other taxable underwriting commissions. Alternatively, if such Stock has not been sold at the expiration of one year from the date of allotment, the market value of the Stock can be considered at that time, and if this shows a loss compared with the written down cost, then such loss can also be used as a setoff against other taxable underwriting commission. As a small practical point, it will probably be found that "probate" valuation, i.e. one quarter of the way up between the lower and upper price extracted from the Stock Exchange Official List will be accepted as the basis of valuation. Should there be an excess of losses of this nature any unused balance can be carried forward into future years.

It will be appreciated that in a period of falling market values such a concession can be very valuable. It is a "one way street" in favour of underwriters, for although in a time of rising market values there would not be many such setoffs against underwriting commission, any profits arising by the sale of such Stocks acquired from an underwriting commitment would not increase the liability for taxation.

2nd July, 1953