Evading Insurance Premium Tax Errors

Karen Jenner of FiscalReps offers her insight into the emerging risks mounting from Insurance Premium Tax (IPT) mistakes and provides advice on how to avoid them.

Illustration by Tiago Galo

Insurance Premium Tax (IPT) is often viewed as a lower tax cost compared to other taxes imposed on insurance companies, though those writing multinational insurance programmes, including those in the captive sector, face increasing risks arising from IPT errors and non-compliance, which can ultimately impact underwriting profits and bottom line results.

The growth of IPT

In the aftermath of the most recent global financial crisis, it is evident that a growing number of governments around the world have either introduced IPT or have strengthened existing IPT regimes. Since 2008 governments across the world have been shifting their attention from the direct taxation of businesses to the taxation of transactions, including insurance transactions, in order to boost revenues. New IPT regimes have been implemented in Hungary, Bulgaria and San Marino within Europe. With regards to increasing rates, in the EU, the Dutch authorities over the last 10 years have increased their IPT rate from 9.7% to 21%; and 2015 saw increases in the UK, Greece, Slovenia and France as well as many other countries.

The increased focus on indirect taxes, and specifically IPT, is further evidenced by a significant increase in the number of IPT compliance investigations and audits conducted by national tax authorities. Audits are not always directed at the insurer, with IPT investigations more recently seen to increasingly arise from audits of a corporate policyholder. These have recently arisen independently from both Belgian and Austrian tax authorities. Not only have investigations sought to review amounts of IPT settled and ensured that there were settled in a timely and compliant manner, but various tax authorities now wish to review and maybe question premium allocations.

UK and German tax authorities have recently been involved in such investigations. With regards to Germany, if as an insurer, premium allocations do not appear to be structured in a way the tax authorities deem not to be a fair allocation with regard to the risks based in Germany, insurers may find the authorities challenging an underpayment of German tax.

It's key that an insurer must be able to demonstrate a fair and reasonable premium allocation and subsequent amount of IPT to a particular jurisdiction, investigations may require production of calculations, paper work and an audit trail, sometimes going back over several years. Other investigations can cover legacy settlements, policy wording reviews and application of appropriate IPT rates.

IPT Wariness

There has also been an increased level of scrutiny around IPT as a recent development allied to concerns by tax authorities, especially in the EU, about the use of transfer pricing. The tax authorities increasingly take the view such costs should be spread across the group on a fair, objective and arm's length basis. This more recent scrutiny may well come to impact the methodology behind insurance premium allocation over the next few years as this is something that governments are beginning to look at very seriously.

Although corporate policyholders may need to report IPT compliance for their own audit purposes, in Europe the insurance company typically pays IPT, with a few niche exceptions where that may not apply. In practice, the responsibility for IPT compliance rests with both the insurer and the policy holder and both have a measure of responsibility to make sure that the premiums are allocated reasonably and the various factors are calculated correctly.

The potential impact of mismanaging IPT on the underwriting performance of a multinational insurance programme can be considerable.

KAREN JENNER

→ Karen Jenner joined FiscalReps as an insurance consultant with over 20 years of experience in the insurance industry. Prior to joining FiscalReps, Karen Jenner was at AIG working in various roles in their Major Accounts Practice, responsible for the global insurance programmes of some of the top 100 FTSE companies.

Implications of non-compliance can impact both the insurer and the policyholder. The ultimate responsibility should fall on the insurance company because it is directly answerable to the tax officials, but there are instances where the policyholder may be pursued.

Some EU countries are in the process of revoking the requirement for foreign insurance companies writing business locally to have a fiscal representative, which up until very recently was a legally mandated appointment. So much so, the partners of the firm acting as the fiscal representative are jointly and severally liable for the payment of any taxes incurred on behalf of the foreign insurer. There have been arguments at the EU level that the requirement to force an EU-based, non-domestic insurer to appoint a fiscal representative when the domestic insurer does not have to do so, is unfair.

Over the last few years, we have seen a number of countries, usually as a result of pressure applied by the EU, revoke the requirement to appoint a fiscal representative. Spain is a good example of this. In 2010, a case was brought against Spain by the European Commission which argued that it was unfair for Spain to force non-Spanish insurers to appoint a fiscal representative. Last year, Spain finally relented following a second case. But, even though the fiscal representative requirement is no longer in force, as an insurer you still need to file and pay IPT and comply with local regulations.

Currently, the average IPT rate in Europe is somewhere between 10% and 15%. This has implications for both providers and buyers of insurance cover. As for a corporate buyer of insurance, especially a multinational corporation, 15% of the total premium amount will be a material figure. It's key to ensure that the right amount of tax is paid because insureds do not want to pay any more tax than is required. As an insurer, it's important to ensure you are collecting the full amount of tax payable but also, as an insurer you are allowed to pass on certain elements of the tax cost to the policyholder. Whatever part of that cost the insurer fails to pass on to the policyholder will effectively come out of the insurer's underwriting profits which, given the current soft market, are marginal at best. This effectively could mean losing money even before considering business claims and service costs.

As both life insurers and reinsurers are often exempt from IPT, the burden of this particular tax falls on non-life insurers, including captive insurance companies.

Avoid IPT Mismanagement

The potential impact of mismanaging IPT on the underwriting performance of a multinational insurance programme can be considerable. Based on a typical IPT rate across Europe of 15%, and an average combined operating ratio of 95% across the majority of the UK insurance market, a 5% IPT error could reduce underwriting profit by 15%.

Take the example of an insurance company writing a US $100m of premium income. With an average rate of IPT in Europe of 15%, there is a potential exposure to IPT of US $15m. If everything is compliantly and correctly managed with regard to IPT, the exposure is zero. But with any errors, your exposure can increase. If at the same time, a combined ratio is about 95%, meaning that on a US $100m premium an insurer can make US $5m of profit, the US $5m of profit is much smaller than the IPT exposure. Any undue increase in your IPT costs will directly impact profits.

Combined ratios of captive insurance companies may differ from those of general insurers – the premium income of captives is known to generally be significant, with the cost of any IPT error equally impacting significantly the profit margin of the captive.

Additionally, there is also the question of reputational damage. For example, should an insurer, for one or other reason, leave an IPT demand unpaid in any country in the EU, a precedent set by the European Court of Justice in the Kvaerner case of 2001 gives national tax authorities the right to pursue the insured if the insurer fails to settle up. This is particularly an issue in the current global regulatory and compliance environment when the tax affairs of corporates are under unprecedented levels of scrutiny from both the tax authorities and the media. Insurers increasingly need to consider effective compliance systems because of the severe consequences that non-compliance can bring: fines, litigation and reputational damage can all result from unpaid taxes. •